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Cola Wars Continue: Coke and Pepsi in the Twenty-First Century

For over a century, Coca-Cola and Pepsi-Cola vied for “throat share” of the world’s beverage market. The most intense battles of the cola wars were fought over the \$60-billion industry in the United States, where the average American consumed 53 gallons of carbonated soft drinks (CSD) per year. In a “carefully waged competitive struggle,” from 1975 to 1995 both Coke and Pepsi achieved average annual growth of around 10% as both U.S. and worldwide CSD consumption consistently rose. According to Roger Enrico, former CEO of Pepsi-Cola:

The warfare must be perceived as a continuing battle without blood. Without Coke, Pepsi would have a tough time being an original and lively competitor. The more successful they are, the sharper we have to be. If the Coca-Cola company didn’t exist, we’d pray for someone to invent them. And on the other side of the fence, I’m sure the folks at Coke would say that nothing contributes as much to the present-day success of the Coca-Cola company than . . . Pepsi.¹

This cozy relationship was threatened in the late 1990s, however, when U.S. CSD consumption dropped for two consecutive years and worldwide shipments slowed for both Coke and Pepsi. In response, both firms began to modify their bottling, pricing, and brand strategies. They also looked to emerging international markets to fuel growth and broadened their brand portfolios to include non-carbonated beverages like tea, juice, sports drinks, and bottled water.

As the cola wars continued into the twenty-first century, the cola giants faced new challenges: Could they boost flagging domestic cola sales? Where could they find new revenue streams? Was their era of sustained growth and profitability coming to a close, or was this apparent slowdown just another blip in the course of Coke’s and Pepsi’s enviable performance?

¹Roger Enrico, *The Other Guy Blinked and Other Dispatches from the Cola Wars* (New York: Bantam Books, 1988).

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Economics of the U.S. CSD Industry

Americans consumed 23 gallons of CSD annually in 1970 and consumption grew by an average of 3% per year over the next 30 years (see **Exhibit 1**). This growth was fueled by increasing availability as well as by the introduction and popularity of diet and flavored CSDs. Through the mid-1990s, the real price of CSDs fell, and consumer demand appeared responsive to declining prices.² Many alternatives to CSDs existed, including beer, milk, coffee, bottled water, juices, tea, powdered drinks, wine, sports drinks, distilled spirits, and tap water. Yet Americans drank more soda than any other beverage. At 60%-70% market share, the cola segment of the CSD industry maintained its dominance throughout the 1990s, followed by lemon/lime, citrus, pepper, root beer, orange, and other flavors.

CSD consisted of a flavor base, a sweetener, and carbonated water. Four major participants were involved in the production and distribution of CSDs: 1) concentrate producers; 2) bottlers; 3) retail channels; and 4) suppliers.³

Concentrate Producers

The concentrate producer blended raw material ingredients (excluding sugar or high fructose corn syrup), packaged it in plastic canisters, and shipped the blended ingredients to the bottler. The concentrate producer added artificial sweetener to make diet soda concentrate, while bottlers added sugar or high fructose corn syrup themselves. The process involved little capital investment in machinery, overhead, or labor. A typical concentrate manufacturing plant cost approximately \$25 million to \$50 million to build, and one plant could serve the entire United States.

A concentrate producer's most significant costs were for advertising, promotion, market research, and bottler relations. Marketing programs were jointly implemented and financed by concentrate producers and bottlers. Concentrate producers usually took the lead in developing the programs, particularly in product planning, market research, and advertising. They invested heavily in their trademarks over time, with innovative and sophisticated marketing campaigns (see **Exhibit 2**). Bottlers assumed a larger role in developing trade and consumer promotions, and paid an agreed percentage—typically 50% or more—of promotional and advertising costs. Concentrate producers employed extensive sales and marketing support staff to work with and help improve the performance of their bottlers, setting standards and suggesting operating procedures. Concentrate producers also negotiated directly with the bottlers' major suppliers—particularly sweetener and packaging suppliers—to encourage reliable supply, faster delivery, and lower prices.

Once a fragmented business with hundreds of local manufacturers, the landscape of the U.S. soft drink industry had changed dramatically over time. Among national concentrate producers, Coca-Cola and Pepsi-Cola, the soft drink unit of PepsiCo, claimed a combined 76% of the U.S. CSD market in sales volume in 2000, followed by Cadbury Schweppes and Cott Corporation (see **Exhibit 3**). There were also private label brand manufacturers and several dozen other national and regional producers. **Exhibit 4** gives financial data for Coke and Pepsi and their top affiliated bottlers.

² Robert Tollison et al., *Competition and Concentration* (Lexington Books, 1991), p.11.

³ The production and distribution of non-carbonated soft drinks and bottled water will be discussed in a later section.

Bottlers

Bottlers purchased concentrate, added carbonated water and high fructose corn syrup, bottled or canned the CSD, and delivered it to customer accounts. Coke and Pepsi bottlers offered “direct store door” (DSD) delivery, which involved route delivery sales people physically placing and managing the CSD brand in the store. Smaller national brands, such as Shasta and Faygo, distributed through food store warehouses. DSD entailed managing the shelf space by stacking the product, positioning the trademarked label, cleaning the packages and shelves, and setting up point-of-purchase displays and end-of-aisle displays. The importance of the bottler’s relationship with the retail trade was crucial to continual brand availability and maintenance. Cooperative merchandising agreements between retailers and bottlers were used to promote soft drink sales. Retailers agreed to specified promotional activity and discount levels in exchange for a payment from the bottler.

The bottling process was capital-intensive and involved specialized, high-speed lines. Lines were interchangeable only for packages of similar size and construction. Bottling and canning lines cost from \$4 million to \$10 million each, depending on volume and package type. The minimum cost to build a small bottling plant, with warehouse and office space, was \$25million to \$35 million. The cost of an efficient large plant, with four lines, automated warehousing, and a capacity of 40 million cases, was \$75 million in 1998.⁴ Roughly 80-85 plants were required for full distribution across the United States. Among top bottlers in 1998, packaging accounted for approximately half of bottlers’ cost of goods sold, concentrate for one-third, and nutritive sweeteners for one-tenth.⁵ Labor accounted for most of the remaining variable costs. Bottlers also invested capital in trucks and distribution networks. Bottlers’ gross profits often exceeded 40%, but operating margins were razor thin. See **Exhibit 5** for the cost structures of a typical concentrate producer and bottler.

The number of U.S. soft drink bottlers had fallen, from over 2,000 in 1970 to less than 300 in 2000.⁶ Historically, Coca-Cola was the first concentrate producer to build nation-wide franchised bottling networks, a move that Pepsi and Cadbury Schweppes followed. The typical franchised bottler owned a manufacturing and sales operation in an exclusive geographic territory, with rights granted in perpetuity by the franchiser. In the case of Coca-Cola, territorial rights did not extend to fountain accounts—Coke delivered to its fountain accounts directly, not through its bottlers. The rights granted to the bottlers were subject to termination only in the event of default by the bottler. The original Coca-Cola franchise contract, written in 1899, was a fixed-price contract that did not provide for contract renegotiation even if ingredient costs changed. With considerable effort, often involving bitter legal disputes, Coca-Cola amended the contract in 1921, 1978, and 1987 to adjust concentrate price. By 1999, over 81% of Coke’s U.S. volume was covered by the 1987 Master Bottler Contract, which granted Coke the right to determine concentrate price and other terms of sale. Under the terms of this contract, Coke was not obligated to share advertising and marketing expenditures with the bottlers; however, the company often did in order to ensure quality and proper distribution of marketing. In 2000, Coke contributed \$766 million in marketing support and \$223 million in infrastructure support to its top bottler alone.

The 1987 contract did not give complete pricing control to Coke, but rather used a pricing formula that adjusted quarterly for changes in sweetener prices and stated a maximum price. This contract differed from Pepsi’s Master Bottling Agreement with its top bottler, which granted the bottler

⁴ “Louisiana Coca-Cola Reveals Crown Jewel,” *Beverage Industry*, January 1999.

⁵ Calculated from M. Dolan et al., “Coca-Cola Beverages,” *Merrill Lynch Capital Markets*, July 6, 1998.

⁶ Timothy Muris et al., *Strategy, Structure, and Antitrust in the Carbonated Soft-Drink Industry*, (Quorum Books, 1993), p.63; John C. Maxwell, ed. *Beverage Digest Fact Book 2001*.

perpetual rights to distribute Pepsi cola products while at the same time required it to purchase its raw materials from Pepsi at prices, and on terms and conditions, determined by Pepsi. Pepsi negotiated concentrate prices with its bottling association, and normally based price increases on the CPI. Coke and Pepsi both raised concentrate prices throughout the 1980s and early 1990s, even as the real (inflation-adjusted) retail prices for CSD were down (see **Exhibit 6**).

Coca-Cola and Pepsi franchise agreements allowed bottlers to handle the non-cola brands of other concentrate producers. Franchise agreements also allowed bottlers to choose whether or not to market new beverages introduced by the concentrate producer. Some restrictions applied, however, as bottlers could not carry directly competitive brands. For example, a Coca-Cola bottler could not sell Royal Crown Cola, but it could distribute Seven-Up, if it decided not to carry Sprite. Franchised bottlers had the freedom to participate in or reject new package introductions, local advertising campaigns and promotions, and test marketing. The bottlers also had the final say in decisions concerning retail pricing, new packaging, selling, advertising, and promotions in its territory, though they could only use packages authorized by the franchiser.

In 1971, the Federal Trade Commission initiated action against eight major CPs, charging that exclusive territories granted to franchised bottlers prevented intrabrand competition (two or more bottlers competing in the same area with the same beverage). The CPs argued that interbrand competition was sufficiently strong to warrant continuation of the existing territorial agreements. After nine years of litigation, Congress enacted the “Soft Drink Interbrand Competition Act” in 1980, preserving the right of CPs to grant exclusive territories.

Retail Channels

In 2000, the distribution of CSDs in the United States took place through food stores (35%), fountain outlets⁷ (23%), vending machines (14%), convenience stores (9%), and other outlets (20%). Mass merchandisers, warehouse clubs, and drug stores made up most of the last category. Bottlers’ profitability by type of retail outlet is shown in **Exhibit 7**. Costs were affected by delivery method and frequency, drop size, advertising, and marketing.

The main distribution channel for soft drinks was the supermarket. CSDs were among the five largest selling product lines sold by supermarkets, traditionally yielding a 15%-20% gross margin (about average for food products) and accounting for 3%-4% of food store revenues.⁸ CSDs represented a large percentage of a supermarket’s business, and were also a big traffic draw. Bottlers fought for retail shelf space to ensure visibility and accessibility for their products, and looked for new locations to increase impulse purchases, such as placing coolers at checkout counters. The proliferation of products and packaging types created intense shelf space pressures.

Discount retailers, warehouse clubs, and drug stores accounted about 15% of CSD sales in the late 1990s. These firms often had their own private label CSD, or they sold a generic label such as President’s Choice. Private label CSDs were usually delivered to a retailer’s warehouse, while branded CSDs were delivered directly to the store. With the warehouse delivery method, the retailer was responsible for storage, transportation, merchandising, and stocking the shelves, thus incurring additional costs.

⁷ The word “fountain outlets” traditionally referred to soda fountains, but was later used also for restaurants, cafeterias, and other establishments that served soft drinks by the glass using fountain dispensers.

⁸ *Progressive Grocer 1998 Sales Manual Databook*, July 1998, p. 68.

Historically, Pepsi had focused on sales through retail outlets, while Coke had dominated fountain sales. Coca-Cola had a 65% share of the fountain market in 2000, while Pepsi had 21%. Competition for fountain sales was intense. National fountain accounts were essentially “paid sampling,” with CSD companies earning pretax operating margins of around 2%. For restaurants, by contrast, fountain sales were extremely profitable—about 80 cents out of every dollar spent stayed with the restaurant retailers. In 1999, for example, Burger King franchisees were believed to pay about \$6.20 per gallon for Coke syrup, but they received a substantial rebate on each gallon in the form of a check; one large Midwestern Burger King franchisee said his annual rebate ran \$1.45 per gallon, or about 23%.⁹ Coke and Pepsi also invested in the development of fountain equipment, such as service dispensers, and provided their fountain customers with cups, point-of-sale material, advertising, and in-store promotions to increase brand presence. After Pepsi entered the fast-food restaurant business with the acquisitions of Pizza Hut (1978), Taco Bell (1986), and Kentucky Fried Chicken (1986), Coca-Cola persuaded other chains such as Wendy’s and Burger King to switch to Coke. PepsiCo spun its restaurant business off to the public in 1997 under the name Tricon, while retaining the Frito-Lay snack food business. In 2000, fountain “pouring rights” remained split along pre-Tricon lines, as Pepsi supplied all of Taco Bell’s and KFC’s, and the overwhelming majority of Pizza Hut restaurants. Coke retained exclusivity deals with McDonald’s and Burger King.

Coke and Cadbury Schweppes handled fountain accounts from their national franchisor companies. Employees of the franchisee companies negotiated and signed pouring rights contracts which, in the case of big restaurant chains, could cover the entire United States or even the world. The accounts were actually serviced by employees of the franchisors’ fountain divisions, local bottlers, or both. Local bottlers, when they were used, were paid service fees for delivering syrup and fixing and placing machines. Historically, PepsiCo could only sell directly to end-user national accounts. By 1999, Pepsi had persuaded most of its bottlers to modify their franchise agreements to allow Pepsi to sell fountain syrup via restaurant commissary companies, which sell a range of supplies to restaurants.

Concentrate producers offered bottlers rebates to encourage them to purchase and install vending machines. The owners of the property on which vending equipment was located usually received a sales commission. Coke and Pepsi were the largest suppliers of CSDs to the vending channel. Juice, tea, sports drinks, lemonade, and water were also available through vending machines.

Suppliers to Concentrate Producers and Bottlers

Concentrate producers required few inputs: the concentrate for most regular colas consisted of caramel coloring, phosphoric and/or citric acid, natural flavors, and caffeine.¹⁰ Bottlers purchased two major inputs: packaging, which included \$3.4 billion in cans, \$1.3 billion in plastic bottles, and \$0.6 billion in glass; and sweeteners, which included \$1.1 billion in sugar and high fructose corn syrup, and \$1.0 billion in artificial sweetener (predominantly aspartame). The majority of U.S. CSDs were packaged in metal cans (60%), then plastic bottles (38%), and glass bottles (2%). Cans were an attractive packaging material because they were easily handled, stocked, and displayed, weighed little, and were durable and recyclable. Plastic bottles, introduced in 1978, boosted home consumption of CSDs because of their larger 1-liter, 2-liter, and 3-liter sizes. Single-serve 20-oz. PET bottles quickly gained popularity and represented 35% of vended drinks and 3% of grocery drinks in 2000.

⁹ Nikhil Deogun and Richard Gibson, “Coke Beats Out Pepsi for Contracts With Burger King, Domino’s,” *The Wall Street Journal*, April 15, 1999.

¹⁰ Based on ingredients lists, Coke Classic and Pepsi-Cola, 2001.

The concentrate producers' strategy towards can manufacturers was typical of their supplier relationships. Coke and Pepsi negotiated on behalf of their bottling networks, and were among the metal can industry's largest customers. Since the can constituted about 40% of the total cost of a packaged beverage, bottlers and concentrate producers often maintained relationships with more than one supplier. In the 1960s and 1970s, Coke and Pepsi backward integrated to make some of their own cans, but largely exited the business by 1990. In 1994, Coke and Pepsi instead sought to establish stable long-term relationships with their suppliers. Major can producers included American National Can, Crown Cork & Seal, and Reynolds Metals. Metal cans were viewed as commodities, and there was chronic excess supply in the industry. Often two or three can manufacturers competed for a single contract.

The Evolution of the U.S. Soft Drink Industry

*Early History*¹¹

Coca-Cola was formulated in 1886 by John Pemberton, a pharmacist in Atlanta, Georgia, who sold it at drug store soda fountains as a "potion for mental and physical disorders." A few years later, Asa Candler acquired the formula, established a sales force, and began brand advertising of Coca-Cola. Tightly guarded in an Atlanta bank vault, the formula for Coca-Cola syrup, known as "Merchandise 7X," remained a well-protected secret. Candler granted Coca-Cola's first bottling franchise in 1899 for a nominal one dollar, believing that the future of the drink rested with soda fountains. The company's bottling network grew quickly, however, reaching 370 franchisees by 1910.

In its early years, Coke was constantly plagued by imitations and counterfeits, which the company aggressively fought in court. In 1916 alone, courts barred 153 imitations of Coca-Cola, including the brands Coca-Kola, Koca-Nola, Cold-Cola, and the like. Coke introduced and patented a unique 6.5-ounce "skirt" bottle to be used by its franchisees that subsequently became an American icon.

Robert Woodruff, who became CEO in 1923, began working with franchised bottlers to make Coke available wherever and whenever a consumer might want it. He pushed the bottlers to place the beverage "in arm's reach of desire," and argued that if Coke were not conveniently available when the consumer was thirsty, the sale would be lost forever. During the 1920s and 1930s, Coke pioneered open-top coolers to storekeepers, developed automatic fountain dispensers, and introduced vending machines. Woodruff also initiated "lifestyle" advertising for Coca-Cola, emphasizing the role of Coke in a consumer's life.

Woodruff also developed Coke's international business. In the onset of World War II, at the request of General Eisenhower, he promised that "every man in uniform gets a bottle of Coca-Cola for five cents wherever he is and whatever it costs the company." Beginning in 1942, Coke was exempted from wartime sugar rationing whenever the product was destined for the military or retailers serving soldiers. Coca-Cola bottling plants followed the movements of American troops; 64 bottling plants were set up during the war—largely at government expense. This contributed to Coke's dominant market shares in most European and Asian countries.

Pepsi-Cola was invented in 1893 in New Bern, North Carolina by pharmacist Caleb Bradham. Like Coke, Pepsi adopted a franchise bottling system, and by 1910 it had built a network of 270

¹¹ See J.C. Louis and Harvey Yazijian, *The Cola Wars* (Everest House, 1980); Mark Pendergrast, *For God, Country, and Coca-Cola* (Charles Scribner's, 1993); David Greising, *I'd Like the World to Buy a Coke* (John Wiley & Sons, 1997).

franchised bottlers. Pepsi struggled, however, declaring bankruptcy in 1923 and again in 1932. Business began to pick up in the midst of the Great Depression, when Pepsi lowered the price for its 12-ounce bottle to a nickel, the same price Coke charged for its 6.5-ounce bottle. When Pepsi tried to expand its bottling network in the late 1930s, its choices were small local bottlers striving to compete with wealthy Coke franchisees.¹² Pepsi nevertheless began to gain market share.

In 1938, Coke filed suit against Pepsi, claiming that Pepsi-Cola was an infringement on the Coca-Cola trademark. The court ruled in favor of Pepsi in 1941, ending a series of suits and countersuits between the two companies. With its famous radio jingle, "Twice as Much, for Nickel Too," Pepsi's U.S. sales surpassed those of Royal Crown and Dr Pepper in the 1940s, trailing only Coca-Cola. In 1950, Coke's share of the U.S. CSD market was 47% and Pepsi's was 10%; hundreds of regional CSD companies continued to produce a wide assortment of flavors.

The Cola Wars Begin

In 1950, Alfred Steele, a former Coca-Cola marketing executive, became Pepsi's CEO. Steele made "Beat Coke" his theme and encouraged bottlers to focus on take-home sales through supermarkets. The company introduced the first 26-ounce bottles to the market, targeting family consumption, while Coke stayed with its 6.5-ounce bottle. Pepsi's growth soon began tracking the growth of supermarkets and convenience stores in the United States: There were about 10,000 supermarkets in 1945, 15,000 in 1955, and 32,000 at the peak in 1962.

In 1963, under the leadership of new CEO Donald Kendall, Pepsi launched its "Pepsi Generation" campaign that targeted the young and "young at heart." Pepsi's ad agency created an intense commercial using sports cars, motorcycles, helicopters, and a catchy slogan. The campaign helped Pepsi narrow Coke's lead to a 2-to-1 margin. At the same time, Pepsi worked with its bottlers to modernize plants and improve store delivery services. By 1970, Pepsi's franchise bottlers were generally larger compared to Coke bottlers. Coke's bottling network remained fragmented, with more than 800 independent franchised bottlers that focused mostly on U.S. cities of 50,000 or less.¹³ Throughout this period, Pepsi sold concentrate to its bottlers at a price approximately 20% lower than Coke. In the early 1970s, Pepsi increased the concentrate price to equal that of Coke. To overcome bottlers' opposition, Pepsi promised to use the extra margin to increase advertising and promotion.

Coca-Cola and Pepsi-Cola began to experiment with new cola and non-cola flavors and a variety of packaging options in the 1960s. Before then, the two companies had adopted a single product strategy, selling only their flagship brand. Coke introduced Fanta (1960), Sprite (1961), and low-calorie Tab (1963). Pepsi countered with Teem (1960), Mountain Dew (1964), and Diet Pepsi (1964). Each introduced non-returnable glass bottles and 12-ounce metal cans in various packages. Coke and Pepsi also diversified into non-soft-drink industries. Coke purchased Minute Maid (fruit juice), Duncan Foods (coffee, tea, hot chocolate), and Belmont Springs Water. Pepsi merged with snack-food giant Frito-Lay in 1965 to become PepsiCo, claiming synergies based on shared customer targets, store-door delivery systems, and marketing orientations.

In the late 1950s, Coca-Cola, still under Robert Woodruff's leadership, began using advertising that finally recognized the existence of competitors, such as "American's Preferred Taste" (1955) and "No Wonder Coke Refreshes Best" (1960). In meetings with Coca-Cola bottlers, however, executives only discussed the growth of their own brand and never referred to its closest competitor by name.

¹² Louis and Yazijian, p. 23.

¹³ Pendergrast, p. 310.

During the 1960s, Coke primarily focused on overseas markets, apparently believing that domestic soft drink consumption had neared saturation at 22.7 gallons per capita in 1970.¹⁴ Pepsi meanwhile battled aggressively in the United States, doubling its share between 1950 and 1970.

The Pepsi Challenge

In 1974, Pepsi launched the “Pepsi Challenge” in Dallas, Texas. Coke was the dominant brand in the city and Pepsi ran a distant third behind Dr Pepper. In blind taste tests hosted by Pepsi’s small local bottler, the company tried to demonstrate that consumers in fact preferred Pepsi to Coke. After its sales shot up in Dallas, Pepsi started to roll out the campaign nationwide, although many of its franchise bottlers were initially reluctant to join.

Coke countered with rebates, rival claims, retail price cuts, and a series of advertisements questioning the tests’ validity. In particular, Coke used retail price discounts selectively in markets where the Coke bottler was company owned and the Pepsi bottler was an independent franchisee. Nonetheless, the Pepsi Challenge successfully eroded Coke’s market share. In 1979, Pepsi passed Coke in food store sales for the first time with a 1.4 share point lead. Breaking precedent, Brian Dyson, president of Coca-Cola, inadvertently uttered the name “Pepsi” in front of Coke’s bottlers at the 1979 bottlers conference.

During the same period, Coke was renegotiating its franchise bottling contract to obtain greater flexibility in pricing concentrate and syrups. Bottlers approved the new contract in 1978 only after Coke conceded to link concentrate price changes to the CPI, adjust the price to reflect any cost savings associated with a modification of ingredients, and supply unsweetened concentrate to bottlers who preferred to purchase their own sweetener on the open market.¹⁵ This brought Coke’s policies in line with Pepsi, which traditionally sold its concentrate unsweetened to its bottlers. Immediately after securing bottler approval, Coke announced a significant concentrate price hike. Pepsi followed with a 15% price increase of its own.

Cola Wars Heat Up

In 1980, Cuban-born Roberto Goizueta was named CEO and Don Keough president of Coca-Cola. In the same year, Coke switched from sugar to the lower-priced high fructose corn syrup, a move Pepsi emulated three years later. Coke also intensified its marketing effort, increasing advertising spending from \$74 million to \$181 million between 1981 and 1984. Pepsi elevated its advertising expenditure from \$66 million to \$125 million over the same period. Goizueta sold off most of the non-CSD businesses he had inherited, including wine, coffee, tea, and industrial water treatment, while keeping Minute Maid.

Diet Coke was introduced in 1982 as the first extension of the “Coke” brand name. Much of Coca-Cola management referred to its brand as “Mother Coke,” and considered it too sacred to be extended to other products. Despite internal opposition from company lawyers over copyright issues, Diet Coke was a phenomenal success. Praised as the “most successful consumer product launch of the Eighties,” it became within a few years not only the nation’s most popular diet soft drink, but also the third-largest selling soft drink in the United States.

¹⁴ Maxwell.

¹⁵ Pendergrast, p. 323.

In April 1985, Coke announced the change of its 99-year-old Coca-Cola formula. Explaining this radical break with tradition, Goizueta saw a sharp depreciation in the value of the Coca-Cola trademark as “the product had a declining share in a shrinking segment of the market.”¹⁶ On the day of Coke’s announcement, Pepsi declared a holiday for its employees, claiming that the new Coke tasted more like Pepsi. The reformulation prompted an outcry from Coke’s most loyal customers. Bottlers joined the clamor. Three months later, the company brought back the original formula under the name Coca-Cola Classic, while retaining the new formula as the flagship brand under the name New Coke. Six months later, Coke announced that Coca-Cola Classic (the original formula) would henceforth be considered its flagship brand.

New CSD brands proliferated in the 1980s. Coke introduced 11 new products, including Cherry Coke, Caffeine-Free Coke, and Minute-Maid Orange. Pepsi introduced 13 products, including Caffeine-Free Pepsi-Cola, Lemon-Lime Slice, and Cherry Pepsi. The number of packaging types and sizes also increased dramatically, and the battle for shelf space in supermarkets and other food stores grew fierce. By the late 1980s, both Coke and Pepsi offered more than ten major brands, using at least seventeen containers and numerous packaging options.¹⁷ The struggle for market share intensified and the level of retail price discounting increased sharply. Consumers were constantly exposed to cents-off promotions and a host of other supermarket discounts.

Throughout the 1980s, the smaller concentrate producers were increasingly squeezed by Coke and Pepsi. As their shelf-space declined, small brands were shuffled from one owner to another. Over five years, Dr Pepper was sold (all and in part) several times, Canada Dry twice, Sunkist once, Shasta once, and A&W Brands once. Some of the deals were made by food companies, but several were leveraged buyouts by investment firms. Philip Morris acquired Seven-Up in 1978 for a big premium, but despite superior brand rankings and established distribution channels, racked up huge losses in the early 1980s and exited in 1985. (*Exhibit 8a* shows the brand performance of top companies, as ranked by retailers.)

In the 1990s, through a series of strategic acquisitions, Cadbury Schweppes emerged as the clear (albeit distant) third-largest concentrate producer, snapping up the Dr Pepper/Seven-Up Companies (1995) and Snapple Beverage Group (2000). (*Appendix A* describes Cadbury Schweppes’ operations and financial performance.)

Bottler Consolidation and Spin-Off

Relations between Coke and its franchised bottlers had been strained since the contract renegotiation of 1978. Coke struggled to persuade bottlers to cooperate in marketing and promotion programs, upgrade plant and equipment, and support new product launches.¹⁸ The cola wars had particularly weakened small independent franchised bottlers. High advertising spending, product and packaging proliferation, and widespread retail price discounting raised capital requirements for bottlers, while lowering their margins. Many bottlers that had been owned by one family for several generations no longer had the resources or the commitment to be competitive.

At a July 1980 dinner with Coke’s fifteen largest domestic bottlers, Goizueta announced a plan to rebrand bottling operations. Coke began buying up poorly managed bottlers, infusing capital,

¹⁶ *The Wall Street Journal*, April 24, 1986.

¹⁷ Timothy Muris, David Scheffman, and Pablo Spiller, *Strategy, Structure, and Antitrust in the Carbonated Soft Drink Industry*. (Quorum Books, 1993), p. 73.

¹⁸ Greising, p. 88.

and quickly reselling them to better-performing bottlers. Refranchising allowed Coke's larger bottlers to expand outside their traditionally exclusive geographic territories. When two of its largest bottling companies came up for sale in 1985, Coke moved swiftly to buy them for \$2.4 billion, preempting outside financial bidders. Together with other bottlers that Coke had recently bought, these acquisitions placed one-third of Coca-Cola's volume in company-owned bottlers. In 1986, Coke began to replace its 1978 franchise agreement with the Master Bottler Contract that afforded Coke much greater freedom to change concentrate price.

Coke's bottler acquisitions had increased its long-term debt to approximately \$1 billion. In 1986, on the initiative of Doug Ivester, who later became CEO, the company created an independent bottling subsidiary, Coca-Cola Enterprises (CCE), and sold 51% of its shares to the public, while retaining the rest. The minority equity position enabled Coke to separate its financial statements from CCE. As Coke's first so-called "anchor bottler," CCE consolidated small territories into larger regions, renegotiated with suppliers and retailers, merged redundant distribution and material purchasing, and cut its work force by 20%. CCE moved towards mega-facilities, investing in 50 million-case production lines with high levels of automation.

Coke continued to acquire independent franchised bottlers and sell them to CCE.¹⁹ "We became an investment banking firm specializing in bottler deals," reflected Don Keough. In 1997 alone, Coke put together more than \$7 billion in deals involving bottlers.²⁰ By 2000, CCE was Coke's largest bottler with annual sales of more than \$14.7 billion, handling 70% of Coke's North American volume. Some industry observers questioned Coke's accounting practice, as Coke retained substantial managerial influence in its arguably independent anchor bottler.²¹

In the late 1980s, Pepsi also acquired MEI Bottling for \$591 million, Grand Metropolitan's bottling operations for \$705 million, and General Cinema's bottling operations for \$1.8 billion. The number of Pepsi bottlers decreased from more than 400 in the mid-1980s to less than 200 in the mid-1990s. Pepsi owned about half of these bottling operations outright and held equity positions in most of the rest. Experience in the snack food and restaurant businesses boosted Pepsi's confidence in its ability to manage the bottling business.

In the late 1990s, Pepsi changed course and also adopted the anchor bottler model. In April 1999, the Pepsi Bottling Group (PBG) went public, with Pepsi retaining a 35% equity stake. By 2000, PBG produced 55% of PepsiCo beverages in North America and 32% worldwide. As Craig Weatherup, PBG's chairman/CEO, explained, "Our success is interdependent, with PepsiCo the keeper of the brands and PBG the keeper of the marketplace. In that regard, we're joined at the hip."²²

The bottler consolidation of the 1990s made smaller concentrate producers increasingly dependent on the Pepsi and Coke bottling network to distribute their products. In response, Cadbury Schweppes in 1998 bought and merged two large U.S. bottlers to form its own bottler. In 2000, Coke's bottling system was the most consolidated, with its top 10 bottlers producing 94% of domestic volume. Pepsi's and Cadbury Schweppes' top 10 bottlers produced 85% and 71% of the domestic volume of their respective franchisors.

¹⁹ Greising, p. 292.

²⁰ *Beverage Industry*, January 1999, p. 17.

²¹ Albert Meyer and Dwight Owsen, "Coca-Cola's Accounting," *Accounting Today*, September 28, 1998

²² Kent Steinriede, "PBG Charts Its Own Course," *Beverage Industry*, May 1, 1999.

Adapting to the Times

In the late 1990s, a variety of problems began to emerge for the soft drink industry as a whole. Although Americans still drank more CSDs than any other beverage, U.S. sales volume registered only a 0.2% increase in 2000, to just under 10 billion cases (a case was equivalent to 24 eight-ounce containers, or 192 ounces). This slow growth was in contrast to the 5%-7% annual growth in the United States during the 1980s. Concurrently, financial crisis in various parts of the world left Coke and Pepsi bottlers over-invested and under-utilized.

Coca-Cola was also impacted by difficulties in leadership transition. After the death of the popular CEO Roberto Goizueta in 1997, his successor Douglas Ivestor had two rocky years at the helm, during which Coke faced a high-profile race discrimination suit and a European public relations scandal after hundreds of people became ill from contaminated soft drinks. Douglas Daft assumed leadership in April 2000; one of his first moves was to lay off 5,200 employees, or 20% of worldwide staff. While expressing "enthusiastic support for the current strategic course of the Company under Doug Daft's leadership," Coke's Board voted against Daft's eleventh-hour negotiations to acquire Quaker Oats in November 2000.

As they had numerous times over the last century, analysts predicted the end of Coke and Pepsi's stellar growth and profitability. Meanwhile, Coke and Pepsi turned their attention to bolstering domestic markets, diversifying into non-carbonated beverages (non-carbs), and cultivating international markets.

Balancing Market Growth, Market Share, and Profitability in the United States

During the early 1990s, Coca-Cola and PepsiCo bottlers employed a low-price strategy in the supermarket channel in order to compete more effectively with high-quality, low-price store brands. As the threat of the low-priced brands lessened, CCE responded in March 1999 with its first major price increase at the retail level after 20 years of flat take-home pricing. Its strategy was to reposition Coke Classic as a premium brand. PBG followed that price increase shortly after. "Price wars had driven soda prices down to the point where bottlers couldn't get a decent return on supermarket sales," explained a Pepsi executive.²³ Observed one industry analyst, "Coke's growth is coming internationally, and Pepsi's is coming from Frito-Lay. It is in the companies' mutual best interest not to destroy the domestic market and eat up each other's share."²⁴ Consumers' initial reaction to price increases was a reduction in supermarket purchases. When CCE raised prices in supermarkets by 6.0%-8.0% in both 1999 and 2000, comparable volumes in North America declined each year (1.5% in 1999 and 0.8% in 2000). In 2001, however, the bottling companies effected more moderate price increases and consumer demand appeared to be on the upswing.

Both Coke and Pepsi also set about to boost the flagging cola market in other ways, including exclusive marketing agreements with Britney Spears (Pepsi) and Harry Potter (Coke). Pepsi reintroduced the highly effective "Pepsi Challenge," which was designed to boost overall cola sales and draw consumers away from private labels as much as it was to plug Pepsi over Coke.

In contrast to the supermarket channel, Coke and Pepsi's rivalry in the fountain channel intensified in the late 1990s. To penetrate Coke's stronghold, Pepsi aggressively pursued national

²³ Lauren R. Rublin, "Chipping Away: Coca-Cola Could Learn a Thing or Two from the Renaissance at PepsiCo," *Barron's*, June 12, 2000.

²⁴ Rublin.

accounts, forcing Coke to make costly concessions to retain its biggest customers. Pepsi broke Coke's stronghold at Disney with a 1998 contract to supply soft drinks at the new DisneyQuest, Club Disney and ESPN Zone chains. After a heated bidding war in 1999 over the 10,000-store chain of Burger King Corporation, Coke again won the fountain contract involving \$220 million per year for 40 million gallons of syrup soda, but only after agreeing to double its \$25 million in rebates to the food chain.

Pepsi also sued Coke over access to the fountain market, charging Coke with "attempting to monopolize the market for fountain-dispensed soft drinks through independent foodservice distributors throughout the United States." Coke persuaded a Federal court to dismiss the suit in 2000. Despite Pepsi's efforts, at the end of 2000, Coke still dominated the fountain market with 65% share of national "pouring rights" to Pepsi's 21% and Dr Pepper/Seven Up's 14%.

The Rise of Non-Cola Beverages

As consumer trends shifted from diet soda, to lemon-lime, to tea-based drinks, to other popular non-carbs, Coke and Pepsi vigorously expanded their brand portfolios. Each new product was accompanied by debate on how much each company should stray from its core product: regular cola. On one hand, cola sales consistently dwarfed alternative beverages sales, and cola-defenders expressed concern that over-enthusiastic expansion would distract the company from its flagship product. Also, history had shown that explosions in demand for alternative drinks were regularly followed by slow or negative growth. On the other hand, as domestic cola demand appeared to plateau, alternative beverages could provide a growth engine for the firms.

By the late 1990s, the soft drink industry had seen various alternative beverage categories come and go. From double-digit expansion in the late 1980s, diet CSDs peaked in 1991 at 29.8% of the CSD segment and then declined to their 1988-level share of 24.4% in 1999. PepsiCo's introduction of Pepsi One in late 1998 was partially responsible for the minor recovery of the diet drink segment. Flavored soft drinks such as citrus, lemon-lime, pepper, and root beer were also popular. In 1999, Mountain Dew grew faster than any other CSD brand for the third year in a row, posting 6.0% volume growth, but in 2000, its growth slowed to 1.5% due to competing "new-age" non-carbs.

At the turn of this century, CSDs accounted for 41.3% of total non-alcoholic beverage consumption, bottled water accounted for 10.3%, and other non-carbs accounted for the remainder.²⁵ When measured in gallons, sales of non-carbs rose by 18% in 1995 and 5% in 2000, compared to 3% and 0.2% respectively for CSDs. The drinks with high growth and high hype were non-carbs such as juices/juice drinks, sports drinks, tea-based drinks, dairy-based drinks—and especially bottled water. In the 1990s, the bottled water industry grew on average 8.3% per year, and volume reached more than 5 billion gallons in 2000. Revenue growth outpaced volume growth, with a 9.3% increase to approximately \$5.6 billion, and per capita consumption gained 5.1 gallons to 13.2 gallons per person. Pepsi's Aquafina went national in 1998. Coke followed in 1999 with Dasani. Though Pepsi and Coke sold reverse-osmosis purified water instead of spring water, they had a distribution advantage over competing water brands.²⁶

Coke and Pepsi launched other new drinks throughout the 1990s. They also aggressively acquired brands that rounded out their portfolios, including Tropicana (Pepsi, 1998), Gatorade (Pepsi,

²⁵ Maxwell. Does not include "tap water / hybrids / all others" category.

²⁶ Reverse osmosis is a method of producing pure water by forcing saline or impure water through a semi-permeable membrane across which salts or impurities cannot pass.

2000), and SoBe (Pepsi, 2000). Both companies predicted that future increases in market share would come from beverages other than CSDs. Pepsi pronounced itself a “total beverage company,” and Coca-Cola appeared to be moving in the same direction, recasting its performance metric from share of the soda market to “share of stomach.” “If Americans want to drink tap water, we want it to be Pepsi tap water,” said Pepsi’s vice-president for new business, describing the philosophy behind the new strategy.²⁷ Coke’s Goizueta had echoed the same view: “Sometimes I think we even compete with soup.”²⁸ Though cola remained the clear leader in terms of both companies’ volume sales, both Coke and Pepsi relied heavily on non-carbs to stimulate their overall growth in the late 1990s. In 1999, non-carbs accounted for 80% of Pepsi’s and more than 100% of Coke’s growth.²⁹

At the turn of the century, Pepsi had the lion’s share of non-CSD sales. Pepsi led Coke by a wide margin in 2000 volume sales in three key segments: Gatorade (76%) led PowerAde (15%) in the \$2.6-billion sports drinks segment, Lipton (38%) led Nestea (27%) in the \$3.5-billion tea-based drinks segment, and Aquafina (13%) led Dasani (8%) in the \$6.0-billion bottled water segment.³⁰ Including multi-serve juices, Tropicana held an approximate 44% share of the \$3-billion chilled orange juice market, more than twice that of Minute Maid.³¹ With the acquisition of Quaker and South Beach Beverages, Pepsi raised its non-carb market share to 31%, to Coke’s 19% (see **Exhibit 8b**).

Non-CSD beverages complicated Coke’s and Pepsi’s traditional production and distribution processes. While bottlers could easily manage some types of alternative beverages (e.g., cold-filled Lipton Brisk), other types required costly new equipment and changes in production, warehousing, and distribution practices (e.g., hot-filled Lipton Iced Tea). In many cases, Coke and Pepsi paid more than half the cost of these investments. The few bottlers that invested in these capabilities either purchased concentrate or other additives from Coke and Pepsi (e.g., Dasani’s mineral packet) or compensated the franchiser through per-unit royalty fees (e.g., Aquafina).

Most bottlers, however, did not invest in hot-fill (for some iced tea), reverse-osmosis (for some bottled water), or other specialized equipment, and instead bought their finished product from a central regional plant or one owned directly by Coca-Cola or PepsiCo. They would then distribute these alongside their own bottled products at a percentage mark-up. More split pallets³² led to slightly higher labor costs, but otherwise did not significantly affect distribution practices. Despite these complicated and evolving arrangements, higher retail prices for alternative beverages meant that margins for the franchiser, bottler, and distributor were consistently higher than on CSDs.

Internationalizing the Cola Wars

As domestic demand appeared to plateau, Coke and Pepsi increasingly looked overseas for new growth. Throughout the 1990s, new access to markets in China, India, and Eastern Europe stimulated some of the most intense battles of the cola wars. In many international markets, per capita consumption levels remained a fraction of those in the United States. For example, while the

²⁷ Marcy Magiera, “Pepsi Moving Fast To Get Beyond Colas,” *Advertising Age*, July 5, 1993.

²⁸ Greising, p. 233.

²⁹ Bonnie Herzog, “PepsiCo, Inc.: The Joy of Growth,” *Credit Suisse First Boston Corporation*, September 8, 2000.

³⁰ Maxwell, p. 152-3.

³¹ Betsy McKay, “Juiced Up: Pepsi Edges Past Coke, and It has Nothing to Do With Cola,” *The Wall Street Journal*, November 6, 2000.

³² Pallets are hard beds, usually of wood, used to organize, store, and transport products. A split pallet carries more than one product type.

average American drank 874 eight-ounce cans of CSDs in 1999, the average Chinese drank 22. In 1999, Coke held a world market share of 53%, compared to Pepsi's 21% and Cadbury Schweppes' 6%. Among major overseas markets, Coke dominated in Western Europe and much of Latin America, while Pepsi had marked presence in the Middle East and Southeast Asia (see **Exhibit 9**).

By the end of World War II, Coca-Cola was the largest international producer of soft drinks. Coke steadily expanded its overseas operations in the 1950s, and the name Coca-Cola soon became a synonym for American culture. Coke built brand presence in developing markets where soft drink consumption was low but potential was large, such as Indonesia: With 200 million inhabitants, a median age of 18, and per capita consumption of 9 eight-ounce cans of soda a year, one Coke executive noted that "they sit squarely on the equator and everybody's young. It's soft drink heaven."³³ By the early 1990s, Coke's CEO Roberto Goizueta said, "Coca-Cola used to be an American company with a large international business. Now we are a large international company with a sizable American business."³⁴

Following Coke, Pepsi entered Europe soon after World War II, and—benefiting from Arab and Soviet exclusion of Coke—into the Middle East and Soviet bloc in the early 1970s. However, Pepsi put less emphasis on its international operations during the subsequent decade. In 1980, international sales accounted for 62% of Coke's soft drink volume, versus 20% for Pepsi. Pepsi rejoined the international battles in the late 1980s, realizing that many of its foreign bottling operations were inefficiently run and "woefully uncompetitive."³⁵ In the early 1990s, Pepsi utilized a niche strategy which targeted geographic areas where per capita consumption was relatively established and the markets presented high volume and profit opportunities. These were often "Coke fortresses," and Pepsi put its guerilla tactics to work, noting that "as big as Coca-Cola is, you certainly don't want a shootout at high noon," said Wayne Calloway, then CEO of PepsiCo.³⁶ Coke struck back; in one high-profile coup in 1996, Pepsi's longtime bottler in Venezuela defected to Coke, temporarily reducing Pepsi's 80% share of the cola market to nearly nothing overnight.

In the late 1990s, Pepsi moved even further away from head-to-head competition and instead concentrated on emerging markets that were still up for grabs. "We kept beating our heads in markets that Coke won 20 years ago," explained Calloway's successor, Roger Enrico. "That is a very difficult proposition."³⁷ In 1999, PepsiCo's bottler sales were up 5% internationally and its operating profit from overseas was up 37%. Market share gains were reported in most of Pepsi-Cola International's top 25 markets, including increases of 10% in India, 16% in China, and more than 100% in Russia. By 2000, international sales accounted for 62% of Coke's and 9% of Pepsi's revenues.

Concentrate producers encountered various obstacles in international operations, including cultural differences, political instability, regulations, price controls, advertising restrictions, foreign exchange controls, and lack of infrastructure. When Coke attempted to acquire Cadbury Schweppes' international practice, for example, it ran into regulatory roadblocks in Europe and in Mexico and Australia, where Coke's market shares exceed 50%. On the other hand, Japanese domestic-protection price controls in the 1950s greased the skids for Coke's high concentrate prices and high profitability, and in India, mandatory certification for bottled drinking water caused several local brands to fold.

³³ John Huey, "The World's Best Brand," *Fortune*, May 31, 1993.

³⁴ John Huey, "The World's Best Brand," *Fortune*, May 31, 1993.

³⁵ Larry Jabbonsky, "Room to Run," *Beverage World*, August 1993.

³⁶ *The Wall Street Journal*, June 13, 1991.

³⁷ John Byrne, "PepsiCo's New Formula: How Roger Enrico is Remaking the Company...and Himself," *BusinessWeek*, April 10, 2000.

To cope with immature distribution networks, Coke and Pepsi created their own ground-up, and often novel, systems. Coke introduced vending machines to Japan, a channel that eventually accounted for more than half of Coke's Japanese sales.³⁸ In India, Pepsi found the most prominent businessman in town and gave him exclusive distribution rights, tapping his connections to drive growth.

Significantly, both Coke and Pepsi recognized local-market demands for non-cola products. In 2000, Coke carried more than 200 brands in Japan alone, most of which were teas, coffees, juices, and flavored water. In Brazil, Coke offered two brands of guarana, a popular caffeinated carbonated berry drink accounting for one-quarter of that country's CSD sales, despite rivals' TV ads ridiculing "gringo guarana."

When the economy foundered in certain parts of the world during the late 1990s, annual consumption declined in many regions. Major financial quakes in East Asia in 1997, Russia in 1998 and Brazil in 1999 shook the cola giants, who had invested heavily in bottler infrastructure. From 1995 to 2000, Coke's top line slowed to an average annual growth of less than 3%. Profits actually fell from \$3.0 billion in 1995 to \$2.2 billion in 2000. In Russia, where Coke invested more than \$700 million from 1991 to 1999, the collapse of the economy caused sales to drop by as much as 60% and left Coke's seven bottling plants operating at 50% capacity. In Brazil, its third-largest market, Coke lost more than 10% of its 54% market share to low-cost local drinks produced by family-owned bottlers exempt from that country's punitive soft-drink taxes. In 1998, Coke estimated that a strong dollar cut into net sales by 9%. Pepsi, with its relatively lower overseas presence, was less affected by the crises. Nonetheless, Pepsi also subsidized its bottlers while experiencing a drop in sales.

Despite these financial setbacks, both Coke and Pepsi expressed confidence in the future growth of international consumption and used the downturn as an opportunity to snatch up bottlers, distribution, and even rival brands. To increase sales, they tried to make their products more affordable through measures such as refundable glass packaging (instead of plastic) and cheaper 6.5-ounce bottles.

The End of an Era?

At the turn of the century, growth of cola sales in the United States appeared to have plateaued. Coke and Pepsi were investing hundreds of millions of dollars to shore up international bottlers operating at low capacity. The companies' overall growth in soft drink sales were falling short of precedent and of investors' expectations. Was the fundamental nature of the cola wars changing? Would the parameters of this new rivalry include reduced profitability and stagnant growth—inconceivable under the old form of rivalry?

Or, were the troubles of the late 1990s just another step in the evolution of two of America's most successful companies? In 2001, non-cola, non-carbs, and even convenience foods offered diversification and growth potential. Low international per capita soft drink consumption figures hinted at tremendous opportunity in the competition for worldwide "throat share." Noted a Coke executive in 2000, "the cola wars are going to be played now across a lot of different battlefields."³⁹

³⁸ June Preston, "Things May Go Better for Coke amid Asia Crisis, Singapore Bottler Says," *Journal of Commerce*, June 29, 1998, p. A3.

³⁹ Betsy McKay, "Juiced Up: Pepsi Edges Past Coke, and It has Nothing to Do With Cola," *The Wall Street Journal*, November 6, 2000.

Exhibit 1 U.S. Industry Consumption Statistics

	1970	1975	1981	1985	1990	1992	1994	1995	1996	1998	1999	2000
Historical Carbonated Soft Drink Consumption												
Cases (millions)	3,090	3,780	5,180	6,500	7,914	8,160	8,608	8,952	9,489	9,880	9,930	9,950
Gallons/capita	22.7	26.3	34.2	40.3	46.9	47.2	50.0	50.9	52.0	54.0	53.6	53.0
As a % of total beverage consumption	12.4	14.4	18.7	22.4	26.1	26.3	27.2	28.1	28.8	30.0	29.4	29.0
U.S. Liquid Consumption Trends (gallons/capita)												
Carbonated soft drinks	22.7	26.3	34.2	40.3	46.9	47.2	50.0	50.9	52.0	54.0	53.6	53.0
Beer	22.8	21.8	20.6	24.0	24.3	23.3	22.8	22.3	22.3	22.1	22.2	22.2
Milk	18.5	21.6	24.3	25.0	24.2	23.8	23.2	22.8	22.7	22.0	21.9	21.7
Coffee ^a	35.7	33	27.2	26.9	26.2	26.5	23.3	21.3	20.2	18.0	17.2	16.8
Bottled Water ^b	-	1.2	2.7	4.5	8.1	8.2	9.6	10.1	11.0	11.8	12.6	13.2
Juices	6.5	6.8	6.9	7.8	8.8	9.1	9.4	9.5	9.7	10.0	10.2	10.4
Tea ^a	5.2	7.3	7.3	7.3	7.0	6.8	7.1	6.8	6.9	6.9	7.0	7.0
Powdered drinks	-	4.8	6	6.2	5.4	5.4	4.8	4.9	4.8	4.7	4.6	4.6
Wine	1.3	1.7	2.1	2.4	2.0	2.0	1.7	1.8	1.8	2.0	2.0	2.0
Sports Drinks ^c	-	-	-	-	-	0.6	0.9	1.1	1.1	1.3	1.4	1.5
Distilled spirits	1.8	2	2	1.8	1.5	1.4	1.3	1.2	1.2	1.3	1.3	1.2
Subtotal	114.5	126.5	133.3	146.2	154.4	154.3	154.0	152.6	153.6	154.1	153.8	153.6
Tap water/hybrids/all others	68	56	49.2	36.3	28.1	28.2	28.5	29.9	28.9	28.4	28.7	28.9
Total ^d	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5

Source: John C. Maxwell, *Beverage Digest Fact Book 2001*, and *The Maxwell Consumer Report*, Feb. 3, 1994; *Adams Liquor Handbook*, casewriter estimates.

^aFrom 1985, coffee and tea data are based on a three-year moving average to counter-balance inventory swings, thereby portraying consumption more realistically.

^bBottled water includes all packages, single-serve, and bulk.

^cSports drinks included in "Tap water/hybrids/all others" pre-1992.

^dThis analysis assumes that each person consumes on average one-half gallon of liquid per day.

Exhibit 2 Advertisement Spending for the Top 10 CSD Brands (\$ millions)

	Share of market		Advertisement Spending ^a		
	2000	1999	2000	1999	per 2000 share point
Coke Classic	20.4	20.3	207.3	148.9	10.2
Pepsi-Cola	13.6	13.8	130.0	91.1	9.6
Diet Coke	8.7	8.5	1.2	25.5	0.1
Mountain Dew	7.2	7.1	50.5	37.1	7.0
Sprite	6.6	6.8	84.0	68.4	12.7
Dr Pepper	6.3	3.6	83.6	71.3	13.3
Diet Pepsi	5.3	5.1	0.5	0.8	0.1
7UP	2.0	2.1	44.5	39.2	22.3
Caffeine Free Diet Coke	1.7	1.8	NA	NA	NA
Barq's root beer	1.1	1.1	2.7	2.9	2.4
Total top 10	72.9	72.9	604.2	485.2	8.3
Total market			707.6	650.0	NA

Source: "Top 10 Soft-Drink Brands," *Advertising Age*, September 24, 2001; casewriter estimates.

^aAdvertisement spending measured in 11 media channels from CMR. Brands and total market in 192-oz cases from Beverage Digest/Maxwell. Case volume from all channels.

Exhibit 3 U.S. Soft Drink Market Share by Case Volume (percent)

	1966	1970	1975	1980	1985	1990	1995	1998	2000E
Coca-Cola Company									
Classic	-	-	-	-	5.2	20.1	20.8	20.6	20.4
Coca-Cola	27.7	28.4	26.2	25.3	16.5	0.6	0.1	0.1	-
Diet Coke	-	-	-	-	6.8	9.3	8.8	8.6	8.7
Sprite and Diet Sprite	1.5	1.8	2.6	3.0	4.7	4.5	5.7	7.1	7.2
Tab	1.4	1.3	2.6	3.3	1.1	0.2	0.1	0.1	0.1
Caffeine Free Coke, Diet Coke, Tab	-	-	-	-	1.8	2.9	2.6	2.4	2.2
Minute Maid brands	-	-	-	-	-	0.7	0.7	1.2	1.5
Barq's and Diet Barq's	-	-	-	-	-	-	0.2	1.5	1.2
Others	<u>2.8</u>	<u>3.2</u>	<u>3.9</u>	<u>4.3</u>	<u>3.4</u>	<u>2.8</u>	<u>3.3</u>	<u>2.9</u>	<u>2.8</u>
Total	33.4	34.7	35.3	35.9	39.5	41.1	42.3	44.5	44.1
PepsiCo, Inc.									
Pepsi-Cola	16.1	17.0	17.4	20.4	19.3	17.6	15.0	14.2	13.6
Diet Pepsi	1.9	1.1	1.7	3.0	3.9	6.3	5.8	5.4	5.3
Pepsi One	-	-	-	-	-	-	-	0.3	0.7
Mountain Dew	1.4	0.9	1.3	3.3	3.1	3.9	5.7	6.7	7.2
Diet Mountain Dew	-	-	-	-	-	0.5	0.7	0.8	0.9
Caffeine Free Pepsi, and Diet Pepsi	-	-	-	-	2.5	2.3	2.0	1.9	1.7
Mug Root Beer	-	-	-	-	-	0.3	0.3	0.8	0.8
Wild Cherry Pepsi	-	-	-	-	-	-	0.2	0.4	0.5
Slice and Diet Slice	-	-	-	-	0.7	1.0	1.0	0.6	0.5
Others	<u>1.0</u>	<u>0.8</u>	<u>0.7</u>	<u>1.1</u>	<u>0.8</u>	<u>0.5</u>	<u>0.2</u>	<u>0.3</u>	<u>0.2</u>
Total	20.4	19.8	21.1	27.8	30.3	32.4	30.9	31.4	31.4
Cadbury Schweppes^a									
Dr Pepper brands	-	-	-	-	-	-	6.8	7.1	7.5
7UP brands	-	-	-	-	-	-	3.3	2.9	2.8
Canada Dry brands	-	-	-	-	1.5	1.2	1.0	0.9	0.9
Sunkist and Diet Sunkist	-	-	-	-	1.2	0.7	0.7	0.6	0.8
Schweppes brands	-	-	-	-	0.5	0.6	0.5	0.5	0.4
A&W brands	-	-	-	-	-	-	1.7	1.5	1.5
Others	-	-	-	-	<u>1.5</u>	<u>0.7</u>	<u>1.1</u>	<u>0.8</u>	<u>0.8</u>
Total					4.7	3.2	15.1	14.3	14.7
Dr Pepper/Seven-Up Cos.^b									
Dr Pepper brands	2.6	3.8	5.5	6.0	4.5	5.2	-	-	-
7UP brands	6.9	7.2	7.6	6.3	5.8	3.9	-	-	-
Others	-	-	-	-	-	<u>0.5</u>	-	-	-
Total						9.6	-	-	-
Cott Corporation									
Royal Crown Cos.	6.9	6.0	5.4	4.7	3.1	2.6	2.0	1.3	1.1
Other companies									
	29.8	28.5	25.1	19.3	12.1	11.1	7.0	5.8	5.4
Total (million cases)	2,927	3,670	4,155	5,180	6,385	7,780	8,970	9,880	9,950

Sources: John C. Maxwell, *Beverage Digest Fact Book 2001*, and *The Maxwell Consumer Report*, Feb. 3, 1994; and the Beverage Marketing Corporation, cited in *Beverage World*, March 1996 and March 1999.

^aCadbury Schweppes acquired A&W brands in 1993, Dr Pepper/Seven-Up Cos. (DPSU) brands in 1995, and Royal Crown in October, 2000. Royal Crown results for 2000E are counted separately.

^bDr Pepper/Seven-Up Companies (DPSU) was formed in 1988. Prior to 1988, Dr Pepper and 7UP brand shares refer to the shares of the respective independent companies, the Dr Pepper Company and the Seven-Up Company. DPSU was acquired by Cadbury Schweppes in 1995.

Exhibit 4 Financial Data for Coke, Pepsi, and their Largest Bottlers (\$ millions)

	1975	1980	1985	1990	1995	1996	1997	1998	1999	2000
Coca-Cola Company^a										
Soft drinks, United States										
Sales	NA	1,486	1,865	2,461	5,513	6,050	6,443	6,934	7,519	7,870
Operating profit/sales		11.1%	11.6%	16.5%	15.5%	15.7%	20.3%	19.9%	19.1%	17.9%
Soft drinks, International										
Sales	NA	2,349	2,677	6,125	12,559	12,576	12,357	11,703	12,286	12,588
Operating profit/sales		21.0%	22.9%	29.4%	29.1%	28.4%	33.3%	29.5%	20.7%	18.2%
Consolidated										
Sales	2,773	5,475	5,879	10,236	18,127	18,673	18,868	18,813	19,805	20,458
Net profit/sales	9.0%	7.7%	12.3%	13.5%	16.5%	18.7%	21.9%	18.8%	12.3%	10.6%
Net profit/equity	21.0%	20.0%	24.0%	36.0%	55.4%	56.7%	56.5%	42.0%	25.6%	23.4%
Long-term debt/assets	3.0%	10.0%	23.0%	8.0%	7.6%	6.9%	4.7%	3.6%	3.9%	4.0%
PepsiCo, Inc.^b										
Soft drinks, United States										
Sales	1,065	2,368	2,725	5,035	7,427	7,734	7,852	8,266	2,605	3,289
Operating profit/sales	10.4%	10.3%	10.4%	13.4%	16.7%	18.3%	16.5%	14.7%	28.8%	25.3%
Soft drinks, International										
Sales	NA	NA	NA	1,489	3,040	2,853	2,689	2,385	1,771	1,842
Operating profit/sales				6.3%	3.9%	-29.1%	-5.1%	-9.2%	6.1%	8.0%
Consolidated										
Sales	2,709	5,975	7,585	17,515	19,067	20,337	20,917	22,348	20,367	20,438
Net profit/sales	4.6%	4.4%	5.6%	6.2%	7.5%	4.6%	7.1%	8.9%	10.1%	10.7%
Net profit/equity	18.0%	20.0%	30.0%	22.0%	19.4%	14.2%	21.5%	31.1%	29.8%	30.1%
Long-term debt/assets	35.0%	31.0%	36.0%	33.0%	35.9%	36.9%	24.6%	17.8%	16.0%	12.8%
Coca-Cola Enterprises (CCE)										
Sales				3,933	6,773	7,921	11,278	13,414	14,406	14,750
Operating profit/sales				8.3%	6.9%	6.9%	6.4%	6.5%	5.8%	7.6%
Net profit/sales				2.4%	1.2%	1.4%	1.5%	1.1%	0.4%	1.6%
Net profit/equity				6.0%	5.7%	7.4%	9.6%	5.8%	2.0%	8.3%
Long-term debt/assets				39.0%	46.3%	47.2%	50.3%	45.5%	44.7%	46.7%
Pepsi Bottling Group (PBG)^b										
Sales						6,603	6,592	7,041	7,505	7,982
Operating profit/sales						5.5%	5.1%	3.9%	5.3%	7.4%
Net profit/sales						0.9%	0.9%	-2.1%	1.6%	2.9%
Net profit/equity						4.5%	3.9%	N/A	7.5%	13.9%
Long-term debt/assets						42.5%	41.7%	45.9%	42.9%	42.3%

Source: Company annual reports.

^aCoca-Cola's soft drink sales were comprised primarily of concentrate sales. Coke's 44% stake in CCE was accounted for by the equity method of accounting. Coke's share of CCE's net earnings was included in its consolidated net income figure. From 1994, Coca-Cola reported U.S. data as part of a North American category that included Canada and Mexico.

^bPepsiCo's soft drink sales included sales by company-owned bottlers. In 1998, PepsiCo began reporting U.S. data as part of a North American category including Canada. PBG was formed and spun off from PepsiCo as a separate entity in 1998. Prior to 1999, PBG financial information refers to the PepsiCo bottling operations that were included in PBG in 1998. From 1999, PepsiCo's share of PBG's net earnings was included in PepsiCo's consolidated net income figure.

Exhibit 5 Comparative Costs of a Typical U.S. Concentrate Producer and Bottler, 2000

	Concentrate Producer		Bottler	
	Dollars per Case ^a	Percent of Sales	Dollars per Case	Percent of Sales
Net sales	0.71	100%	5.80	100%
Cost of sales	0.12	17	3.77	65
Gross profit	0.59	83	2.03	35
Selling and delivery	0.01	2	1.22	21
Advertising and marketing	0.28	39	0.12	2
General and administration	0.06	8	0.23	4
Pretax profit	0.25	35	0.52	9

Sources: Industry analysts and casewriter estimates. Profit and loss percentage data modified from Andrew Conway, "Global Soft Drink Bottling Review and Outlook: Consolidating the Way to a Strong Bottling Network," *Morgan Stanley Dean Witter*, August 4, 1997, p. 2. Net sales dollars per case data based on John C. Maxwell, *Beverage Digest Fact Book 2001*, p. 59.

^aOne case is equivalent to 192 oz.

Exhibit 6 U.S. CSD Industry Pricing and Volume Statistics

	1988	1990	1992	1994	1996	1998	2000	Total Change 1988-2000
Retail price per 288-oz case	\$8.78	\$8.99	\$8.87	\$8.63	\$8.70	\$8.55	\$9.08	\$0.30
Change in retail price ^a		1.2%	-0.7%	-1.4%	0.4%	-0.9%	3.1%	0.3%
Concentrate price per 288-oz case	\$0.79	\$0.86	\$0.97	\$1.00	\$1.07	\$1.14	\$1.29	\$0.50
Change in concentrate price		4.3%	6.2%	1.5%	3.4%	3.2%	6.4%	4.2%
Volume (bil cases)	4.9	5.2	5.3	5.8	6.2	6.6	6.6	1.7
Change in volume		3.0%	1.0%	4.6%	3.4%	3.2%	0.0%	2.5%
Consumption (gallons/capita)	40.3	46.9	47.2	50.0	52.0	54.0	53.0	12.7
Change in consumption		7.9%	0.3%	2.9%	2.0%	1.9%	-0.9%	2.3%
Consumer Price Index (1988=100)	100	110	119	125	133	138	146	46
Change in CPI		5.1%	3.6%	2.8%	2.9%	1.9%	2.8%	3.2%

Source: Adapted from John C. Maxwell, *Beverage Digest Fact Book 2001*.

^aAll change calculated using Compounded Annual Growth Rate (CAGR).

Exhibit 7 U.S. CSD Retail Outlets, 2000

	Food Stores	Convenience Stores	Fountain	Vending	Other	Total
Percent of industry volume	34.8%	8.5%	23.1%	13.5%	20.1%	100.0%
Share of channel:						
Coca-Cola (all brands)	36.1%	35.7%	65.0%	50.0%	35.5%	44.1%
Pepsi-Cola (all brands)	32.2%	41.5%	21.0%	40.0%	33.3%	31.4%
Other brands	31.7%	22.9%	14.0%	10.0%	31.2%	24.5%
Bottling Profitability Per Case:^a						
Net Price	\$3.53	\$5.35	\$3.18 ^b	\$8.48	\$3.42	\$4.24
NOPBT ^b	\$0.23	\$0.69	\$0.09 ^b	\$0.97	\$0.33	\$0.36

Source: Industry analysts and casewriter estimates.

^aOne case is equivalent to 192 oz.

^bNet Operating Profit Before Tax.

^cIndustry average, excluding Coca-Cola bottlers. The Coca-Cola Company supplies fountain outlets directly.

Exhibit 8 Top Food and Beverage Brands in the Late 1990s**A. Retailers' Assessment of Brand Performance, 1999 Survey**

	Top 5 Rank Order (% responding in top 3)				
Consumer brands most important to retailers	P&G 71.8%	Kraft 43.6%	Coca-Cola 34.6%	General Mills 14.7%	Pepsi-Cola 14.4%
Best brand marketers overall	P&G 61.9%	Kraft 36.7%	Coca-Cola 31.5%	Frito-Lay 17.5%	Pepsi-Cola 13.5%
Best sales force/customer teams	P&G 50.3%	Kraft 39.8%	Coca-Cola 19.8%	General Mills 19.4%	Con-Agra 11.2%
Most innovative marketing programs	P&G 33.9%	Kraft 27.8%	General Mills 22.9%	Coca-Cola 17.1%	Frito-Lay 12.5%
Most helpful customer information	P&G 57.6%	Kraft 34.6%	Coca-Cola 18.2%	General Mills 12.0%	Unilever 9.4%
Best supply chain management	P&G 61.8%	Kraft 37.5%	General Mills 17.2%	Coca-Cola 11.3%	Unilever 10.6%

Source: Adapted from Cannondale Associates: Power Ranking Survey, 1999, as cited in Bonnie Herzog, "PepsiCo, Inc.: The Joy of Growth," *Credit Suisse First Boston Corporation*, September 8, 2000.

B. Soft Drink Megabrands, 2000^a

Brand	Owner	Category	2000E Cases (mil)	2000E Share	Share Change	Volume Change
<u>Top 12 Brands</u>						
Coke	Coke	CSD	3,192.6	25.9	-0.4	+0.8%
Pepsi	Pepsi	CSD	2,159.9	17.5	-0.5	-0.6%
Mt. Dew	Pepsi	CSD	809.8	6.6	flat	+2.1%
Dr Pepper	Cadbury	CSD	747.5	6.1	-0.1	+1.2%
Sprite	Coke	CSD	713.0	5.8	-0.2	-1.8%
Gatorade	Quaker (Pepsi) ^b	Non-Carb	325.0	2.6	+0.2	+9.8%
7UP	Cadbury	CSD	276.1	2.2	flat	-0.1%
Lipton	Pepsi/Unilever	Non-Carb	155.2	1.3	-0.1	-2.0%
Minute Maid	Coke	Non-Carb	145.0	1.2	+0.1	+10.0%
Barq's	Coke	CSD	121.2	1.0	flat	+2.5%
Nestea	Coke/Nestle	Non-Carb	113.5	0.9	flat	-1.0%
Snapple	Cadbury	Non-Carb	103.5	0.8	flat	+3.0%
Aquafina	Pepsi	Water	100.7	0.8	+0.2	+32.0%
<u>Select Other Brands</u>						
Poland Spring	Perrier	Water	91.8	0.7	+0.2	+34.0%
Dasani	Coke	Water	65.1	0.5	+0.3	+117.0%
Hawaiian Punch	Cadbury	Non-Carb	64.9	0.5	flat	+0.8%
PowerAde	Coke	Non-Carb	62.6	0.5	flat	+0.5%
SoBe	Pepsi	Non-Carb	44.0	0.4	+0.1	+49.7%
Arizona Ice Tea	Ferolito, Vultaggio & Sons	Non-Carb	40.4	0.3	flat	+8.9%
Tropicana	Pepsi	Non-Carb	36.5	0.3	flat	+4.9%
All-Sport	Pepsi	Non-Carb	18.5	0.2	-0.1	-26.9%

Source: John C. Maxwell, *Beverage Digest Fact Book 2001*; casewriter estimates.

^aSingle-serving portions only. In this exhibit, "non-carb" beverages do not include bottled water.

^bPepsiCo acquired The Quaker Oats Company in August, 2001.

Exhibit 9 Soft Drink Industry—Selected International Market Shares, 1999

	Population (000)	Consumption (8-oz per capita)		Annual Growth 1992-1999	Coca- Cola	Share Pepsi- Cola	Cadbury Schweppes
		1999	1992				
Europe / Eurasia (7.0 bil cases)^a							
Germany	82,087	344	432	-3%	56	8	1
United Kingdom	59,113	370	224	7%	43	12	0
Spain	39,168	386	304	3%	60	16	5
Italy	56,735	212	208	0%	45	8	1
France	58,978	158	128	3%	60	8	5
Russia	146,394	52	NA	NA	26	12	0
Poland	38,609	155	NA	NA	28	17	1
Netherlands	15,808	356	NA	NA	45	15	1
Hungary	10,186	273	NA	NA	57	29	5
Romania	22,334	104	NA	NA	44	9	0
Czech Republic	10,281	215	NA	NA	36	13	2
Latin America (6.9 bil cases)							
Mexico	100,294	590	528	2%	70	19	3
Brazil	171,853	276	128	12%	51	7	0
Argentina	36,738	374	256	6%	59	24	0
Colombia	39,309	181	NA	NA	60	8	0
Venezuela	23,203	290	NA	NA	70	30	0
Chile	14,974	392	288	5%	81	4	0
Peru	26,625	108	NA	NA	50	16	0
Asia Pacific (4.1 bil cases)							
China	1,246,872	22	13	8%	34	16	0
Philippines	79,346	205	112	9%	70	18	0
Japan	126,182	92	96	-1%	55	11	0
Australia	18,784	502	400	3%	57	10	16
Thailand	60,609	114	80	5%	52	45	0
India	1,000,849	6	NA	NA	56	44	0
South Korea	46,885	108	128	-2%	54	13	0
Indonesia	216,108	9	NA	NA	94	6	0
Pakistan	138,123	14	NA	NA	25	71	3
Vietnam	77,311	15	NA	NA	63	36	0
Africa / Middle East (2.3 bil cases)							
South Africa	43,426	207	NA	NA	97	0	0
Saudi Arabia	21,505	229	NA	NA	24	76	0
Egypt	67,274	50	NA	NA	60	40	0
Israel	5,750	400	NA	NA	70	14	0
Morocco	29,662	63	NA	NA	96	4	0
North America (10.7 bil cases)							
United States	272,640	874	768	2%	44	31	15
Canada	31,006	489	432	2%	39	35	9
Total Worldwide (31 bil cases)							
	5,996,000	125	NA	NA	53	21	6

Sources: Manny Goldman, "The Coca-Cola Company and PepsiCo: A Worldwide Soft Drink Comparison and Analysis," *Ing Barings*, November 2000; John C. Maxwell, *Beverage Digest Fact Book 2001*; industry analysts; casewriter estimates.

^aOne case is equivalent to 192 oz.

Appendix A Cadbury Schweppes Operations and Financial Performance

In the late 1990s, Cadbury Schweppes emerged as the clear, albeit distant, third-largest player in the U.S. soft drinks industry. Its products accounted for 14.7% of CSDs and 13.6% of non-carbs sold in 2000. Its brands include Dr Pepper, 7UP, Schweppes, Canada Dry, A&W, Squirt, Sundrop, Welch's, Country Time, Clamato, Hawaiian Punch, Mr.&Mrs. T's, Rose's, Snapple, Mystic, and Stewart's. In 2001, the company was in negotiations with Pernod Ricard to acquire its Yoo-Hoo and Orangina brands.

The U.K.-based firm was born of the 1969 merger between Jacob Schweppes' mineral water business (founded in 1783) and John Cadbury's cocoa and chocolate business (founded in 1842). In the mid-1980s, the group decided to focus on its core international confectionery and soft drinks businesses. In 1989, its beverage headquarters relocated from London, England, to Stamford, Connecticut. During the 1980s and the early 1990s, its soft drink and confectionery brand portfolio was strengthened and extended through the acquisition of a number of key brands, notably Mott's (1982), Canada Dry (1986), Trebor (1989), and Bassett's (1989). Its acquisition of Dr Pepper/Seven-Up Companies in 1995 boosted its U.S. CSD market share from 4.6% in 1994 to 15.1% in 1995, and its acquisition of Triarc's Mystic and Snapple brands in 2001 more than doubled its non-carb market share from 6.0% in 1999. In 1999, Cadbury Schweppes disposed of its soft drinks brands in around 160 countries, concentrating its beverages interests on North America, Europe and Australia.

In 2000, Cadbury Schweppes operated primarily as a licensor, selling concentrate and syrups to independently owned bottling and canning operations (certain of which were affiliated with competitors) to which it also provided marketing support and technical manufacturing oversight. In the United States, Cadbury Schweppes had a 40% interest in the Dr Pepper/Seven Up Bottling Group (DPSUBG). In certain countries (including the United States, for Mott's), Cadbury Schweppes manufactured, bottled, marketed, sold, and distributed (occasionally through independent brokers) its soft drinks itself.

Table A Cadbury Schweppes Financial Data (\$ millions)

	2000	1999
Soft drinks, North America		
Sales	\$2,273	\$2,046
Operating profits/sales	26.7%	26.3%
Soft drinks, Europe ^a		
Sales	\$699	\$741
Operating profit/sales	15.0%	11.6%
Consolidated ^b		
Sales	\$6,833	\$6,849
Net profit/sales	16.9%	16.2%
Net profit/equity	18.6%	24.4%
Long-term debt/assets	11.3%	12.6%

Source: Company annual reports.

^aSoft drink sales in Asia Pacific; Africa, India, and Middle East; and Central and Other divisions are not reported separately from confectionary sales in those regions.

^bIncludes worldwide confectionary sales.