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DAVID B. YOFFIE

RENEE KIM

Cola Wars Continue: Coke and Pepsi in 2010

For more than a century, Coke and Pepsi vied for "throat share" of the world's beverage market. The most intense battles in the so-called cola wars were fought over the $74 billion carbonated soft drink (CSD) industry in the United States.[1] In a "carefully waged competitive struggle" that lasted from 1975 through the mid-1990s, both Coke and Pepsi achieved average annual revenue growth of around 10%, as both U.S. and worldwide CSD consumption rose steadily year after year.[2] According to Roger Enrico, former CEO of Pepsi:

> 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.[3]

That relationship began to fray in the early 2000s, however, as U.S. per-capita CSD consumption started to decline. By 2009, the average American drank 46 gallons of CSDs per year, the lowest CSD consumption level since 1989.[4] At the same time, the two companies experienced their own distinct ups and downs; Coke suffered several operational setbacks while Pepsi charted a new, aggressive course in alternative beverages and snack acquisitions.

As the cola wars continued into the 21st century, Coke and Pepsi faced new challenges: Could they boost flagging domestic CSD sales? How could they compete in the growing non-CSD category that demanded different bottling, pricing, and brand strategies? What had to be done to ensure sustainable growth and profitability?

Economics of the U.S. CSD Industry

Americans consumed 23 gallons of CSDs annually in 1970, and consumption grew by an average of 3% per year over the next three decades (see **Exhibit 1**). Fueling this growth were the increasing availability of CSDs and the introduction of diet and flavored varieties. Declining real (inflation-adjusted) prices that made CSDs more affordable played a significant role as well.[5] There were many

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alternatives to CSDs, 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. Within the CSD category, the cola segment maintained its dominance, although its market share dropped from 71% in 1990 to 55% in 2009.[6] Non-cola CSDs included lemon/lime, citrus, pepper-type, orange, root beer, and other flavors. CSDs consisted of a flavor base (called "concentrate"), a sweetener, and carbonated water. The production and distribution of CSDs involved four major participants: concentrate producers, bottlers, retail channels, and suppliers.[7]

Concentrate Producers

The concentrate producer blended raw material ingredients, packaged the mixture in plastic canisters, and shipped those containers to the bottler. To make concentrate for diet CSDs, concentrate makers often added artificial sweetener; with regular CSDs, bottlers added sugar or high-fructose corn syrup themselves. The concentrate manufacturing process involved relatively little capital investment in machinery, overhead, or labor. A typical concentrate manufacturing plant, which could cover a geographic area as large as the United States, cost between $50 million to $100 million to build.[8]

A concentrate producer's most significant costs were for advertising, promotion, market research, and bottler support. Using innovative and sophisticated campaigns, they invested heavily in their trademarks over time. While concentrate producers implemented and financed marketing programs jointly with bottlers, they usually took the lead in developing those programs, particularly when it came to product development, market research, and advertising. They also took charge of negotiating "customer development agreements" (CDAs) with nationwide retailers such as Wal-Mart. Under a CDA, Coke or Pepsi offered funds for marketing and other purposes in exchange for shelf space. With smaller regional accounts, bottlers assumed a key role in developing such relationships, and paid an agreed-upon percentage—typically 50% or more—of promotional and advertising costs. Concentrate producers employed a large staff of people who worked with bottlers by supporting sales efforts, setting standards, and suggesting operational improvements. They also negotiated directly with their bottlers' major suppliers (especially sweetener and packaging makers) to achieve reliable supply, fast delivery, and low prices.[9]

Once a fragmented business that featured hundreds of local manufacturers, the U.S. soft drink industry had changed dramatically over time. Among national concentrate producers, Coke and Pepsi claimed a combined 72% of the U.S. CSD market's sales volume in 2009, followed by Dr Pepper Snapple Group (DPS) and Cott Corporation (see **Exhibits 2, 3a** and **3b**). In addition, there were private-label manufacturers and several dozen other national and regional producers.

Bottlers

Bottlers purchased concentrate, added carbonated water and high-fructose corn syrup, bottled or canned the resulting CSD product, and delivered it to customer accounts. Coke and Pepsi bottlers offered "direct store door" (DSD) delivery, an arrangement whereby route delivery salespeople managed the CSD brand in stores by securing shelf space, stacking CSD products, positioning the brand's trademarked label, and setting up point-of-purchase or end-of-aisle displays. (Smaller national brands, such as Shasta and Faygo, distributed through food store warehouses.) Cooperative merchandising agreements, in which retailers agreed to specific promotional activity and discount levels in exchange for a payment from a bottler, were another key ingredient of soft drink sales.

The bottling process was capital-intensive and involved high-speed production lines that were interchangeable only for products of similar type and packages of similar size. Bottling and canning

lines cost from $4 million to $10 million each, depending on volume and package type. But the cost of a large plant with multiple lines and automated warehousing could reach hundreds of millions of dollars. In 2010, DPS completed construction of a production facility in California with a capacity of 40 million cases at an estimated cost of $120 million.[10] While a handful of such plants could theoretically provide enough capacity to serve the entire United States, Coke and Pepsi each had around 100 plants for nationwide distribution.[11] For bottlers, their main costs components were concentrate and syrup. Other significant expenses included packaging, labor, and overhead.[12] Bottlers also invested capital in trucks and distribution networks. For CSDs, bottlers' gross profits routinely exceeded 40% but operating margins were usually around 8%, about a third of concentrate producers' operating margins (see **Exhibit 4**).

The number of U.S. soft drink bottlers had fallen steadily, from more than 2,000 in 1970 to fewer than 300 in 2009.[13] Coke was the first concentrate producer to build a nationwide franchised bottling network, and Pepsi and DPS followed suit. 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 Coke, territorial rights did not extend to national fountain accounts, which the company handled directly. The original Coca-Cola franchise agreement, written in 1899, was a fixed-price contract that did not provide for renegotiation, even if ingredient costs changed. After considerable negotiation, often accompanied by bitter legal disputes, Coca-Cola amended the contract in 1921, 1978, and 1987. By 2009, 92% of Coke's U.S. concentrate sales for bottled and canned beverages was covered by its 1987 Master Bottler Contract, which granted Coke the right to determine concentrate price and other terms of sale.[14] Under this contract, Coke had no legal obligation to assist bottlers with advertising or marketing. Nonetheless, to ensure quality and to match Pepsi, Coke made huge investments to support its bottling network. In 2009, for example, Coke contributed $540 million in marketing support payments to its top bottler.[15]

The 1987 contract did not give complete pricing control to Coke, but rather used a formula that established a maximum price and adjusted prices quarterly according to changes in sweetener pricing. This contract differed from Pepsi's Master Bottling Agreement with its top bottler. That agreement granted the bottler perpetual rights to distribute Pepsi's CSD products but required it to purchase 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 consumer price index (CPI). Over the last two decades, however, concentrate makers regularly raised concentrate prices, often by more than the increase in inflation (see **Exhibit 5**).

Franchise agreements with both Coke and Pepsi allowed bottlers to handle the non-cola brands of other concentrate producers. Bottlers could choose whether to market new beverages introduced by a concentrate producer. However, concentrate producers worked hard to "encourage" bottlers to carry their product offerings. Bottlers could not carry directly competing brands, however. For example, a Coke bottler could not sell Royal Crown Cola, yet it could distribute 7UP if it did not carry Sprite. Franchised bottlers could decide whether to participate in test marketing efforts, local advertising campaigns and promotions, and new package introductions (although they could only use packages authorized by their franchiser). Bottlers also had the final say in decisions about retail pricing.

In 1971, the Federal Trade Commission initiated action against eight major concentrate makers, charging that the granting of exclusive territories to bottlers prevented intrabrand competition (that is, two or more bottlers competing in the same area with the same beverage). The concentrate makers argued that interbrand competition was strong enough to warrant continuation of the existing territorial agreements. In 1980, after years of litigation, Congress enacted the Soft Drink Interbrand Competition Act, which preserved the right of concentrate makers to grant exclusive territories.

Retail Channels

In 2009, the distribution of CSDs in the United States took place through supermarkets (29.1%), fountain outlets (23.1%), vending machines (12.5%), mass merchandisers (16.7%), convenience stores and gas stations (10.8%), and other outlets (7.8%). Small grocery stores and drug chains made up most of the latter category.[16] Costs and profitability in each channel varied by delivery method and frequency, drop size, advertising, and marketing (see **Exhibit 6**).

CSDs accounted for $12 billion, or 4% of total store sales in the U.S., and were also a big traffic draw for supermarkets.[17] Bottlers fought for shelf space to ensure visibility for their products, and they looked for new ways to drive impulse purchases, such as placing coolers at checkout counters. An ever-expanding array of products and packages created intense competition for shelf space.

The mass merchandiser category included discount retailers, such as Wal-Mart and Target. These companies formed an increasingly important channel. Although they sold Coke and Pepsi products, they (along with some drug chains) could also have their own private-label CSD, or sell 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 stores. With the warehouse delivery method, the retailer was responsible for storage, transportation, merchandising, and stocking the shelves, thereby incurring additional costs.

Historically, Pepsi had focused on sales through retail outlets, while Coke commanded the lead in fountain sales. (The term "fountain," which originally referred to drug store soda fountains, covered restaurants, cafeterias, and any other outlet that served soft drinks by the glass using fountain-type dispensers.) Competition for national fountain accounts was intense, especially in the 1990s. In 1999, for example, Burger King franchises were believed to pay about $6.20 per gallon for Coke syrup, but they received a substantial rebate on each gallon; one large Midwestern franchise owner said that his annual rebate ran $1.45 per gallon, or about 23%.[18] Local fountain accounts, which bottlers handled in most cases, were considerably more profitable than national accounts. To support the fountain channel, Coke and Pepsi invested in the development of service dispensers and other equipment, and provided fountain customers with point-of-sale advertising and other in-store promotional material.

After Pepsi entered the fast-food restaurant business by acquiring Pizza Hut (1978), Taco Bell (1986), and Kentucky Fried Chicken (1986), Coca-Cola persuaded competing chains such as Wendy's and Burger King to switch to Coke. In 1997, PepsiCo spun off its restaurant business under the name Tricon, but fountain "pouring rights" remained split along largely pre-Tricon lines.[19] In 2009, Pepsi supplied all Taco Bell and KFC restaurants and the great majority of Pizza Hut restaurants, and Coke retained deals with Burger King and McDonald's (the largest national account in terms of sales). Competition remained vigorous: In 2004, Coke won the Subway account away from Pepsi, while Pepsi grabbed the Quiznos account from Coke. (Subway was the largest account as measured by number of outlets.) In April 2009, DPS secured rights for Dr Pepper at all U.S. McDonald's restaurants.[20] Yet Coke continued to lead the channel with a 69% share of national pouring rights, against Pepsi's 20% and DPS' 11%.[21]

Coke and DPS had long retained control of national fountain accounts, negotiating pouring-rights contracts that in some cases (as with big restaurant chains) covered the entire United States or even the world. Local bottlers or the franchisors' fountain divisions serviced these accounts. (In such cases, bottlers received a fee for delivering syrup and maintaining machines.) Historically, PepsiCo had ceded fountain rights to local Pepsi bottlers. But in the late 1990s, Pepsi began a successful campaign to gain from its bottlers the right to sell fountain syrup via restaurant commissary companies.[22]

In the vending channel, bottlers took charge of buying, installing, and servicing machines, and for negotiating contracts with property owners, who typically received a sales commission in exchange for accommodating those machines. But concentrate makers offered bottlers financial incentives to encourage investment in machines, and also played a large role in the development of vending technology. Coke and Pepsi were by far the largest suppliers of CSDs to this channel.

Suppliers to Concentrate Producers and Bottlers

Concentrate producers required few inputs: the concentrate for most regular colas consisted of caramel coloring, phosphoric or citric acid, natural flavors, and caffeine.[23] Bottlers purchased two major inputs: packaging (including cans, plastic bottles, and glass bottles), and sweeteners (including high-fructose corn syrup and sugar, as well as artificial sweeteners such as aspartame). The majority of U.S. CSDs were packaged in metal cans (56%), with plastic bottles (42%) and glass bottles (2%) accounting for the remainder.[24] Cans were an attractive packaging material because they were easily handled and displayed, weighed little, and were durable and recyclable. Plastic packaging, introduced in 1978, allowed for larger and more varied bottle sizes. Single-serve 20-oz PET bottles, introduced in 1993, steadily gained popularity; in 2009, they represented 35% of CSD volume (and 52% of CSD revenues) in convenience stores.[25]

The concentrate producers' strategy toward 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. In the 1960s and 1970s, both companies took control of a portion of their own can production, but by 1990 they had largely exited that business. Thereafter, they sought instead to establish stable long-term relationships with suppliers. In 2009, major can producers included Ball, Rexam (through its American National Can subsidiary), and Crown Cork & Seal.[26] Metal cans were essentially a commodity, and often two or three can manufacturers competed for a single contract.

The Evolution of the U.S. Soft Drink Industry[27]

Early History

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." In 1891, Asa Candler acquired the formula, established a sales force, and began brand advertising of Coca-Cola. The formula for Coca-Cola syrup, known as "Merchandise 7X," remained a well-protected secret that the company kept under guard in an Atlanta bank vault. 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, imitations and counterfeit versions of Coke plagued the company, which aggressively fought trademark infringements in court. In 1916 alone, courts barred 153 imitations of Coca-Cola, including the brands Coca-Kola, Koca-Nola, and Cold-Cola. Coke introduced and patented a 6.5-oz bottle whose unique "skirt" design subsequently became an American icon.

Candler sold the company to a group of investors in 1919, and it went public that year. Four years later, Robert Woodruff began his long tenure as leader of the company. Woodruff pushed franchise bottlers to place the beverage "in arm's reach of desire," by any and all means. During the 1920s and 1930s, Coke pioneered open-top coolers for use in grocery stores and other channels, developed

automatic fountain dispensers, and introduced vending machines. Woodruff also initiated "lifestyle" advertising for Coca-Cola, emphasizing the role that Coke played in a consumer's life.

Woodruff developed Coke's international business as well. During World War II, at the request of General Eisenhower, Woodruff 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 won exemptions from wartime sugar rationing for production of beverages that it sold to the military or to retailers that served soldiers. Coca-Cola bottling plants followed the movement of American troops, and during the war the U.S. government set up 64 such plants overseas—a development that contributed to Coke's dominant postwar 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 bottlers. Pepsi struggled, however; it declared bankruptcy in 1923 and again in 1932. But business began to pick up when, during the Great Depression, Pepsi lowered the price of its 12-oz bottle to a nickel—the same price that Coke charged for a 6.5-oz bottle. In the years that followed, Pepsi built a marketing strategy around the theme of its famous radio jingle: "Twice as much for a nickel, too."

In 1938, Coke filed suit against Pepsi, claiming that the Pepsi-Cola brand was an infringement on the Coca-Cola trademark. A 1941 court ruling in Pepsi's favor ended a series of suits and countersuits between the two companies. During this period, as Pepsi sought to expand its bottling network, it had to rely on small local bottlers that competed with wealthy, established Coke franchisees.[28] Still, the company began to gain market share, surpassing Royal Crown and Dr Pepper in the 1940s to become the second-largest-selling CSD brand. In 1950, Coke's share of the U.S. market was 47% and Pepsi's was 10%; hundreds of regional CSD companies, which offered a wide assortment of flavors, made up the rest of the market.[29]

The Cola Wars Begin

In 1950, Alfred Steele, a former Coke marketing executive, became CEO of Pepsi. Steele made "Beat Coke" his motto and encouraged bottlers to focus on take-home sales through supermarkets. To target family consumption, for example, the company introduced a 26-oz bottle. Pepsi's growth began to follow the postwar growth in the number of supermarkets and convenience stores in the United States: There were about 10,000 supermarkets in 1945; 15,000 in 1955; and 32,000 in 1962, at the peak of this growth curve.

Under the leadership of CEO Donald Kendall, Pepsi in 1963 launched its "Pepsi Generation" marketing campaign, which targeted the young and "young at heart." 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 to improve store delivery services. By 1970, Pepsi bottlers were generally larger than their Coke counterparts. Coke's network remained fragmented, with more than 800 independent franchised bottlers (most of which served U.S. cities of 50,000 or less).[30] Throughout this period, Pepsi sold concentrate to its bottlers at a price that was about 20% lower than what Coke charged. In the early 1970s, Pepsi increased its concentrate prices to equal those of Coke. To overcome bottler opposition, Pepsi promised to spend this extra income on advertising and promotion.

Coke and Pepsi began to experiment with new cola and non-cola flavors, and with new packaging options, in the 1960s. Previously, the two companies had sold only their flagship cola brands. Coke launched Fanta (1960), Sprite (1961), and the low-calorie cola Tab (1963). Pepsi countered with Teem (1960), Mountain Dew (1964), and Diet Pepsi (1964). Both companies introduced non-returnable glass bottles and 12-oz metal cans in various configurations. They also diversified into non-CSD industries.

Coke purchased Minute Maid (fruit juice), Duncan Foods (coffee, tea, hot chocolate), and Belmont Springs Water. In 1965, Pepsi merged with snack-food giant Frito-Lay to form PepsiCo, hoping to achieve synergies based on similar customer targets, delivery systems, and marketing orientations.

In the late 1950s, Coca-Cola began to use advertising messages that implicitly recognized the existence of competitors: "American's Preferred Taste" (1955), "No Wonder Coke Refreshes Best" (1960). In meetings with Coca-Cola bottlers, however, executives discussed only the growth of their own brand and never referred to its closest competitor by name. During the 1960s, Coke focused primarily on overseas markets, apparently basing its strategy on the assumption that domestic CSD consumption was approaching a saturation point. Pepsi, meanwhile, battled Coke aggressively in the United States, and doubled its U.S. share between 1950 and 1970.

The Pepsi Challenge

In 1974, Pepsi launched the "Pepsi Challenge" in Dallas, Texas. Coke was the dominant brand in that city, and Pepsi ran a distant third behind Dr Pepper. In blind taste tests conducted by Pepsi's small local bottler, the company tried to demonstrate that consumers actually preferred Pepsi to Coke. After its sales shot up in Dallas, Pepsi rolled out the campaign nationwide.

Coke countered with rebates, retail price cuts, and a series of advertisements that questioned the tests' validity. In particular, it employed retail price discounts in markets where a company-owned Coke bottler competed against an independent Pepsi bottler. Nonetheless, the Pepsi Challenge successfully eroded Coke's market share. In 1979, Pepsi passed Coke in food store sales for the first time, opening up a 1.4 share-point lead. In a sign of the times, Coca-Cola president Brian Dyson inadvertently uttered the name Pepsi at a 1979 bottlers' conference.

During this period, Coke renegotiated its franchise bottling contract to obtain greater flexibility in pricing concentrate and syrups. Its bottlers approved a new contract in 1978, but only after Coke agreed to link concentrate price changes to the CPI, to adjust the price to reflect any cost savings associated with ingredient changes, and to supply unsweetened concentrate to bottlers that preferred to buy their own sweetener on the open market.[31] This arrangement brought Coke in line with Pepsi, which traditionally had sold unsweetened concentrate to its bottlers. Immediately after securing approval of the new agreement, Coke announced a significant concentrate price increase. Pepsi followed with a 15% price increase of its own.

Cola Wars Heat Up

In 1980, Roberto Goizueta was named CEO of Coca-Cola, and Don Keough became its president. That year, Coke switched from using sugar to using high-fructose corn syrup, a lower-priced alternative. Pepsi emulated that move three years later. Coke also intensified its marketing effort, more than doubling its advertising spending between 1981 and 1984. In response, Pepsi doubled its advertising expenditures over the same period. Meanwhile, Goizueta sold off most of the non-CSD businesses that he had inherited, including wine, coffee, tea, and industrial water treatment, while retaining Minute Maid.

Diet Coke, introduced in 1982, was the first extension of the "Coke" brand name. Many Coke managers, deeming the "Mother Coke" brand sacred, had opposed the move. So had company lawyers, who worried about copyright issues. Nonetheless, Diet Coke was a huge success. Praised as the "most successful consumer product launch of the Eighties," it became within a few years not only the most popular diet soft drink in the United States, but also the nation's third-largest-selling CSD.

In April 1985, Coke announced that it had changed the 99-year-old Coca-Cola formula. Explaining this radical break with tradition, Goizueta cited a sharp depreciation in the value of the Coca-Cola trademark. "The product and the brand," he said, "had a declining share in a shrinking segment of the market."[32] On the day of Coke's announcement, Pepsi declared a holiday for its employees, claiming that the new Coke mimicked Pepsi in taste. The reformulation prompted an outcry from Coke's most loyal customers, and 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 its flagship brand under the name New Coke. Six months later, Coke announced that it would henceforth treat Coca-Cola Classic (the original formula) as its flagship brand.

New CSD brands proliferated in the 1980s. Coke introduced 11 new products, including Caffeine-Free Coke (1983) and Cherry Coke (1985). Pepsi introduced 13 products, including Lemon-Lime Slice (1984) and Caffeine-Free Pepsi-Cola (1987). The number of packaging types and sizes also increased dramatically, and the battle for shelf space in supermarkets and other stores became fierce. By the late 1980s, Coke and Pepsi each offered more than 10 major brands and 17 or more container types.[33] The struggle for market share intensified, and retail price discounting became the norm. Consumers grew accustomed to such discounts.

Throughout the 1980s, the growth of Coke and Pepsi put a squeeze on smaller concentrate producers. As their shelf space declined, small brands were shuffled from one owner to another. Over a five-year span, Dr Pepper was sold (all or in part) several times, Canada Dry twice, Sunkist once, and A&W Brands once. Philip Morris acquired Seven-Up in 1978 for a big premium, racked up huge losses in the early 1980s, and then left the CSD business in 1985. In the 1990s, through a series of strategic acquisitions, Cadbury Schweppes emerged as the third-largest concentrate producer—the main (albeit distant) competitor of the two CSD giants. It bought the Dr Pepper/Seven-Up Companies in 1995, and continued to add such well-known brands as Orangina (2001) and Nantucket Nectars (2002) to its portfolio. Then in 2008, Cadbury's beverage business was spun off into an independent company, Dr Pepper Snapple Group.

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, to upgrade plant and equipment, and to support new product launches.[34] The cola wars had particularly weakened small, independent bottlers. Pressures to spend more on advertising, product and packaging proliferation, widespread retail price discounting—together, these factors resulted in higher capital requirements and lower profit margins. Many family-owned bottlers no longer had the resources needed to remain competitive.

At a July 1980 dinner with Coke's 15 largest domestic bottlers, Goizueta announced a plan to refranchise bottling operations. Coke began buying up poorly managed bottlers, infusing them with capital, 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 bidders. Together with other recently purchased bottlers, these acquisitions placed one-third of Coke's volume in company-owned operations. Meanwhile, Coke began to replace its 1978 franchise agreement with what became the 1987 Master Bottler Contract.

Coke's bottler acquisitions had increased its long-term debt to approximately $1 billion. In 1986, the company created an independent bottling subsidiary, Coca-Cola Enterprises (CCE), selling 51% of its shares to the public and retaining the rest. The minority equity position enabled Coke to separate

its financial statements from those of CCE. As Coke's first "anchor bottler," CCE consolidated small territories into larger regions, renegotiated contracts with suppliers and retailers, merged redundant distribution and purchasing arrangements, and cut its work force by 20%. CCE also invested in building 50-million-case production lines that involved high levels of automation. Coke continued to acquire independent franchised bottlers and sell them to CCE. "We became an investment banking firm specializing in bottler deals," said Don Keough.[35] In 1997 alone, Coke put together more than $7 billion in such deals.[36] As of 2009, CCE was Coke's largest bottler. It handled about 75% of Coke's North American bottle and can volume, and logged annual sales of more than $21 billion.

In the late 1980s, Pepsi acquired MEI Bottling for $591 million, Grand Metropolitan's bottling operations for $705 million, and General Cinema's bottling operations for $1.8 billion. After operating the bottlers for a decade, Pepsi shifted course and adopted Coke's anchor bottler model. In April 1999, the Pepsi Bottling Group (PBG) went public, with Pepsi retaining a 35% equity stake in it. By 2009, PBG produced 56% of PepsiCo's total volume, while the total number of Pepsi bottlers had fallen from more than 400 in the mid-1980s to 106.[37]

Bottler consolidation made smaller concentrate producers increasingly dependent on the Pepsi and Coke bottling networks for distribution of their products. In response, DPS in 1998 bought and merged two large U.S. bottling companies to form its own bottler. In 2009, Coke had the most consolidated system, with its top 10 bottlers producing 94% of domestic volume. Pepsi's and DPS' top 10 bottlers produced 89% and 79% of the domestic volume of their respective franchisors.[38]

Adapting to the Times

Starting in the late 1990s, the soft drink industry encountered new challenges that suggested a possible long-term shift in the marketplace. Although Americans still drank more CSDs than any other beverage, U.S. consumption began to fizzle (see **Exhibit 1**). That stood in contrast to annual growth rates of 3% to 7% during the 1980s and early 1990s.[39]

This shift in consumption patterns evolved around the growing linkage between CSDs and health issues such as obesity and nutrition. New federal nutrition guidelines, issued in 2005, identified regular CSDs as the largest source of obesity-causing sugars in the American diet.[40] Schools throughout the nation banned the sale of soft drinks on their premises. Several states pushed for a "soda tax" on sugary drinks like sodas and energy beverages. A U.S. government study suggested that a 20% tax could cut the calorie intake from sugary drinks by up to 49 calories a day per person in the United States.[41] As of April 2010, 29 states already taxed sodas and around 12 more states were considering the measure.[42] In addition, a greater number of consumers started to perceive high-fructose corn syrup as unnatural and unhealthy. According to one market research study, 53% of Americans were concerned that the ingredient posed a health hazard in 2010, compared to 40% in 2004.[43] In fact, Coke's 2009 annual report identified obesity and health concerns as the number one risk factor to its business.[44]

In face of dwindling CSD sales (see **Exhibit 7)**, Coke and Pepsi tried to stem the tide by enticing consumers with stepped-up innovation and marketing. In Coke's case, the company revealed a new Freestyle soda machine in 2009 which could create dozens of different kinds of custom beverages; restaurants had to pay a 30% premium for the Freestyle compared to a regular soda fountain.[45] Coke also placed a greater emphasis on promoting its brands, such as spending $230 million in advertising for its flagship Cola-Cola drink (see **Exhibit 8**). It also upped spending on sponsorships and global marketing, including $600 million for the World Cup in 2010.[46] Meanwhile, Pepsi redesigned its logo in 2008 with a three-year rebranding plan that could cost over $1 billion to rejuvenate its image. Pepsi

focused on promoting the company's overall portfolio as a snack and beverage company, such as through "The Power of One" concept. Market surveys on brand loyalty indicated that more consumers preferred Coke over Pepsi as their favorite CSD brand towards 2010, a slight setback for Pepsi after it had significantly narrowed the gap in the late 1990s.[47]

The Quest for Alternatives

Expanding the product mix offered another avenue for growth. Diet sodas, for example, rose to capture 30% of the CSD market in 2009 compared to 24% a decade ago.[48] Coca-Cola Zero became the most successful new CSD product launched in the second half of the decade. The beverage, which offered the "real Coca-Cola taste with zero calories", experienced consecutive double-digit growth since its introduction in 2005. It was primarily marketed to younger men around the world who shunned the "diet" label.

At the same time, both Coke and Pepsi intensified their efforts to use alternative sweeteners. Pepsi replaced high-fructose corn syrup with natural sugar for its brands, Pepsi Throwback and Mountain Dew Throwback. Another possible alternative was Stevia, an herb that could be used as a natural, zero-calorie sweetener. Coke and Pepsi both developed their own versions of a Stevia-based sweetener, which were approved to be used as a food additive by the U.S. Food and Drug Administration in 2008. New Stevia-based product releases followed, including Pepsi's reduced-calorie Trop 50 (orange juice), and Coke's Sprite Green, with plans to expand to more CSDs as well.

Despite some success with diet drinks, Coke and Pepsi realized that growth would involve "non-carbs"—a category that included juices and juice drinks, sports drinks, energy drinks, and tea-based drinks—and also on bottled water (see **Exhibit 9**). In 2009, while CSDs accounted for 63% of U.S. non-alcoholic refreshment beverage volume (down from 81% in 2000), the remaining volume was made up of bottled water at 20% (up from 7%) and non-carbs at 17% (up from 13%).[49]

Initially, Pepsi was more aggressive than Coke in shifting to non-CSDs. Declaring itself to be a "total beverage company," Pepsi developed a portfolio of non-CSD products that outsold Coke's rival product in several key categories, such as sports drink (Gatorade) and tea-based drinks (Lipton). Between 2004 and 2007, 77% of Pepsi's new products released in the U.S. market were non-carbs compared to Coke's 56%.[50] But starting in 2007, Coke aggressively expanded its non-carbs product portfolio through acquisitions. Most notable was its $4 billion purchase of Energy Brands, maker of the popular Vitaminwater drinks. The deal was the biggest acquisition Coke had ever made. Coke also entered the business of supplying coffee and tea to fountain/foodservice customers. By 2009, Pepsi had 43% of the U.S. non-carbs market share compared to Coke's 32%.[51]

In the $14 billion bottled-water category, both Pepsi (with Aquafina, 1998) and Coke (with Dasani, 1999) had introduced purified-water products that had surged to become leading beverage brands. Using their distribution prowess, they had outstripped competing brands, many of which sold spring water. However, the economic downturn in the late 2000s dampened future prospects for what had been the fastest growing beverage category between 2000 and 2007.[52] Price-sensitive consumers sought cheaper alternatives such as private label bottled-water or tap water, exhibiting little brand loyalty compared to CSDs. Environmentalists also became more vocal in their criticisms against the use of plastic bottles, known as PET, which had a recycling rate below 25%.[53] Bottled water started to generate negative operating profit margins. Coke also saw its market share in this category slip to 15% in 2009 (compared to 22% in 2004) while Pepsi's fell to 11% (compared to 14%).[54]

Internationalizing the Beverage Wars

As U.S. demand for CSDs softened, Coke and Pepsi also looked abroad for new growth. The United States remained the largest market, accounting for a third of global CSD consumption, followed by Mexico, Puerto Rico, and Argentina.[55] But improved access to markets in Asia and Eastern Europe stimulated new demand. In particular, China and India emerged as future battlegrounds with a large, growing middle class population. Each company planned to invest about $2 billion in China over the next few years to build up their market presence.

Coke flourished, and also relied upon, international markets far more than Pepsi. Through steady expansion, the Coca-Cola name had become synonymous with American culture. Served in more than 200 countries, Coke derived about 80% of its sales from international markets.[56] Pepsi, on the other hand, depended on the U.S. for roughly half of its total sales.[57] Earlier efforts to go after Coke in core international markets generated relatively little success. By the early 2000s, Pepsi chose to focus on emerging markets that were still up for grabs. Several of its top CSD markets were in Asia, Middle East, and Africa.

Since CSD consumption abroad was generally lower compared to the United States, Coke and Pepsi aggressively pursued non-carbs opportunities in global markets. For instance, juice was a popular category—its retail value in China was expected to grow 94% by 2012 compared to 30% for CSDs.[58] In Russia, Pepsi and PBC paid $1.4 billion for a 76% stake in Russia's largest juice producer, OAO Lebedyansky, in 2008. International operations, however, encountered several obstacles, including antitrust regulation, foreign exchange controls, advertising restrictions, and local competition. In one high-profile incident, the Chinese government rejected Coke's $2.4 billion bid to buy Huiyan Juice, a leading juice company in China. At the same time, overseas markets enabled Coke and Pepsi to broaden the scope of innovation. To tailor to local tastes, Coke offered Sprite Tea, which blended green tea with Sprite, while Pepsi experimented with beverages made out of Chinese herbs. New approaches to packaging abounded as well.[59] In China and India, use of small returnable glass bottles allowed Coke to reach poor, rural consumers at a very low price point, while boosting revenue-per-ounce.[60]

Evolving Structures and Strategies

Both at home and abroad, the growing popularity of alternative beverages brewed complications for CSD makers' traditional production and distribution practices. Concentrate companies became more directly involved in the manufacturing of several non-CSDs, ranging from Gatorade to Lipton Iced Tea. Such finished goods required a smaller but specialized production process that were challenging for bottlers to make with their existing infrastructure. As the popularity of non-carbs continued to grow, bottlers were frustrated that they were not fully participating in the new growth businesses. Coke and Pepsi sold the finished goods to their bottlers, who distributed them alongside their own bottled products at a percentage markup. In addition, Coke and Pepsi distributed some non-CSDs directly to the retailers' warehouses, bypassing bottlers.

Energy and sports drinks promised better margins than CSDs because they commanded premium prices and were usually chosen for immediate, single-serve consumption (see **Exhibit 10**). In convenience stores, energy drinks had an average case price of $34.32 compared to CSD's $8.99.[61] Yet volume for such products, while growing fast, remained small in comparison with CSD volume. This created issues with DSD, which worked best with high-volume, high consumer demand products.

All CSD companies faced the challenge of achieving pricing power in the take-home channels. In particular, the rapid growth of the mass-merchandisers, led by Wal-Mart, and various club stores

posed a new threat to profitability for Coke, Pepsi, and their bottlers. Consolidation in the retail sector meant that the top ten customers represented as much as 40% of Coke's U.S. package volume.[62] In the case of Wal-Mart, it not only used its size to exert pricing pressure, it also insisted on negotiating marketing and shelving arrangements directly with concentrate makers. This left bottlers feeling vulnerable in their traditional practice of distributing products in their exclusive territories.

In addition, bottlers had to manage an ever-rising number of stock-keeping units (SKUs).[63] For instance, Pepsi wanted its bottlers to carry 47 different Gatorade SKUs in exchange for gaining distribution rights to smaller but more profitable channels like convenience and dollar stores.[64] Many non-CSDs sold in relatively low volume, leading to an increased use of "split pallets." By loading more than one product type on a pallet (the hard, wooden bed used to organize and transport merchandise), bottlers incurred higher distribution and sales costs. Some of Coke's biggest bottlers saw their cost of goods sold (including operating expenses) reach 90% of their sales, the highest level in more than two decades.[65]

Not surprisingly, bottlers complained over Coke's practice of charging a flat rate for its concentrate in the U.S. market. Coke's profits were tied to volume growth while bottlers' profits were driven by package types and where the drinks were sold.[66] Then in 2003, Coke and CCE moved toward "incidence pricing", an approach that Coke often used with its overseas bottlers, whereby Coke agreed to vary concentrate prices according to prices charged in different channels and for different packages. By 2009, around 90% of Coke's total volume was covered under incidence pricing agreements. Annual price negotiations were also replaced with multi-year concentrate-price agreements. With some bottlers, Coke pursued more 50-50 joint ventures. Motivating its independent bottlers became critical, especially for Coke, as they accounted for nearly 90% of Coke's worldwide sales volume.[67]

Bottler Consolidation, Again

In 2009, Pepsi announced that it would buy two of its biggest bottlers, PBG and PepsiAmericas, in a transaction worth $7.8 billion. The offer came just about ten years after Pepsi had spun off PBG into an independent company. The merger would consolidate more than 80% of Pepsi's North America beverage operations under one roof.[68] One analyst noted that the deal acknowledged the "changing realities of the North American beverage business."[69] Then Coke, which had been a loyal defender of the franchise bottling system, surprised the world with its decision to buy CCE's North American operations in February 2010. The deal brought back 90% of Coke's North America business under its control. In return, CCE bought Coke's own bottling operations in Norway and Sweden, and received the option to buy Coke's stake in its German bottling business at a later date.

Future of the Cola Wars?

Declining CSD sales, declining cola sales, and the rapid emergence of non-carbonated drinks appeared to be changing the game in the cola wars. By spending billions of dollars to bring bottling operations under Coke and Pepsi's direct control again, observers couldn't help but wonder: was this a fundamental shift in the cola wars or was this just one more round in a 100 year rivalry?

Exhibit 1 U.S. Beverage Industry Consumption Statistics

	1970	1975	1981	1985	1990	1995	2000	2005	2007	2008	2009
Historical Carbonated Soft Drink Consumption											
Cases[a] (millions)	3,090	3,780	5,180	6,500	7,780	9,000	9,950	10,220	9,920	9,620	9,420
Gallons/capita	22.7	26.3	34.2	40.3	46.9	50.9	53.0	51.9	49.3	47.4	46.0
As share of total beverage consumption	12.4%	14.4%	18.7%	22.1%	25.7%	27.9%	29.0%	28.3%	27.1%	26.0%	25.2%
U.S. Liquid Consumption Trends (gallons/capita)											
Carbonated soft drinks	22.7	26.3	34.2	40.3	46.9	50.9	53.0	51.7	49.3	47.4	46.0
Beer	22.8	21.8	20.6	24.0	24.0	21.9	21.8	21.4	22.0	21.7	21.0
Milk	18.5	21.6	24.3	25.0	24.2	22.8	21.3	20.3	21.7	21.4	21.5
Bottled water[b]	—	1.2	2.7	4.5	8.1	10.1	13.2	19.5	22.5	21.4	20.6
Coffee[c]	35.7	33.0	27.2	26.9	26.2	21.3	16.8	16.4	16.0	15.9	15.8
Juices	6.5	6.8	6.9	8.1	8.5	8.9	9.5	8.2	8.1	7.6	8.1
Tea[c]	5.2	7.3	7.3	7.3	7.0	6.8	7.0	7.0	7.1	7.3	7.3
Sports drinks[d]	—	—	—	—	—	1.3	2.2	4.2	4.9	4.6	4.0
Powdered drinks	—	4.8	6.0	6.2	5.4	4.5	3.0	2.6	2.2	2.3	2.4
Wine	1.3	1.7	2.1	2.4	2.0	1.8	1.9	2.2	2.5	2.6	2.6
Distilled spirits	1.8	2.0	2.0	1.8	1.5	1.2	1.2	1.4	1.4	1.4	1.4
Subtotal	114.5	126.5	133.3	146.5	153.8	151.5	150.9	155.2	155.9	152.7	150.7
Tap water/hybrids/all others	68.0	56.0	49.2	36.0	28.7	31.0	31.6	27.6	24.8	28.9	31.8
Total[e]	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5	182.5

Source: Compiled from *Beverage Digest Fact Book 2001*, *The Maxwell Consumer Report*, Feb. 3, 1994; *Adams Liquor Handbook*, casewriter estimates; and *Beverage Digest Fact Book 2005*. Data for 1990 and afterward comes from *Beverage Digest Fact Book 2005* and *2010*, which reports that some of that data has been "restated compared to previous editions of the Fact Book."

[a] One case is equivalent to 192 oz.

[b] Bottled water includes all packages, single-serve as well as bulk.

[c] For 1985 and afterward, coffee and tea data are based on a three-year moving average.

[d] For pre-1992 data, sports drinks are included in "Tap water/hybrids/all others."

[e] This analysis assumes that each person consumes, on average, one half-gallon of liquid per day.

Exhibit 2 U.S. Soft Drink Market Share by Unit Case Volume (%)

	1970	1980	1985	1990	1995	2000	2005	2009E[a]
Coca-Cola Company								
Coca-Cola[b]	28.4	25.3	21.7	20.7	20.9	20.4	17.6	17.0
Diet Coke	—	—	6.8	9.3	8.8	8.7	9.8	9.9
Sprite and Diet Sprite	1.8	3.0	4.7	4.5	5.7	7.2	6.3	6.1
Caffeine Free Coke, Diet Coke	—	—	1.7	2.9	2.6	2.2	1.8	1.4
Fanta[c]	—	—	0.9	0.7	0.7	0.2	1.6	1.8
Barq's and Diet Barq's	—	—	—	—	0.2	1.2	1.1	1.1
Minute Maid brands	—	—	—	0.7	0.7	1.5	0.1	—
Tab	1.3	3.3	1.1	0.2	0.1	—	—	—
Others	3.2	4.3	2.6	2.8	3.3	4.2	4.9	4.6
Total	**34.7**	**35.9**	**39.5**	**41.1**	**42.3**	**44.1**	**43.1**	**41.9**
PepsiCo, Inc.								
Pepsi-Cola	17.0	20.4	19.3	17.6	15.0	13.6	11.2	9.9
Mountain Dew	0.9	3.3	3.1	3.9	5.7	7.2	6.5	6.7
Diet Pepsi	1.1	3.0	3.9	6.3	5.8	5.3	6.0	5.6
Sierra Mist	—	—	—	—	—	0.1	1.4	1.3
Diet Mountain Dew	—	—	—	0.5	0.7	0.9	1.4	1.9
Caffeine Free Pepsi, and Diet Pepsi	—	—	2.5	2.3	2.0	1.7	1.4	1.0
Mug Root Beer	—	—	—	0.3	0.3	0.8	0.7	0.7
Slice and Diet Slice	—	—	1.4	1.4	1.2	0.6	0.1	0.1
Others	0.8	1.1	0.1	0.1	0.2	1.2	2.7	2.7
Total	**19.8**	**27.8**	**30.3**	**32.4**	**30.9**	**31.4**	**31.4**	**29.9**
Dr Pepper Snapple Group[d]								
Dr Pepper (all brands)	3.8	6.0	4.5	5.2	6.8	7.5	7.6	8.3
7UP (all brands)	7.2	6.3	5.8	3.9	3.3	2.8	1.7	1.6
A&W brands	—	—	—	—	0.9	0.9	1.0	1.1
Sunkist	—	—	1.2	0.7	0.7	0.8	1.1	1.2
Canada Dry	—	—	1.5	1.2	1.0	0.9	0.8	1.0
Schweppes	—	—	0.5	0.6	0.5	0.4	0.4	0.5
Others	—	—	1.5	0.7	1.9	1.4	2.0	2.7
Total	**11.0**	**12.3**	**15.0**	**12.3**	**15.1**	**14.7**	**14.6**	**16.4**
Cott Corporation	—	—	—	—	2.7	3.3	5.4	4.9
Royal Crown Cos.	6.0	4.7	3.1	2.6	2.0	1.1	—	—
Other companies	28.5	19.3	12.1	11.6	7.0	5.4	5.5	6.9
Total case volume (in millions)	**3,670**	**5,180**	**6,385**	**7,780**	**8,970**	**9,950**	**10,224**	**9,416**

Source: Compiled from *Beverage Digest Fact Book 2001*, *2005*, and *2010*; *The Maxwell Consumer Report*, February. 3, 1994; the Beverage Marketing Corporation, cited in *Beverage World*, March 1996 and March 1999.

[a] Expected market share. One unit case is equivalent to 192 oz.

[b] Between 1985 and 1995, market share includes Coca-Cola Classic. Coca-Cola drops the name "classic" in 2009.

[c] For the period before 1985, Fanta sales are included under "Others."

[d] For the years preceding 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. Then, Cadbury Schweppes acquired A&W brands in 1993, Dr Pepper/Seven-Up Cos. brands in 1995, and Royal Crown brands in 2000. In 2008, Cadbury Schweppes' beverage brands came under the control of the Dr Pepper Snapple Group.

Exhibit 3a Financial Data for Coca-Cola and PepsiCo ($ millions)

	1975	1980	1985	1990	1995	2000	2005	2007	2008	2009
Coca-Cola Company[a]										
Beverages, North America:										
Sales	—	1,486	1,865	2,461	5,513	7,870	6,676	7,836	8,280	8,271
Operating profits/sales	—	11.1%	11.6%	16.5%	15.5%	17.9%	23.3%	21.6%	19.1%	20.5%
Beverages, International:										
Sales	—	2,349	2,677	6,125	12,559	12,588	16,345	20,778	22,611	22,231
Operating profit/sales	—	21.0%	22.9%	29.4%	29.1%	27.1%	35.4%	33.2%	35.2%	34.6%
Consolidated:										
Sales	2,773	5,475	5,879	10,236	18,127	20,458	23,104	28,857	31,944	30,990
Net profit/sales	9.0%	7.7%	12.3%	13.5%	16.5%	10.6%	21.1%	20.7%	18.2%	22.0%
Net profit/equity	21.0%	20.0%	24.0%	36.0%	55.4%	23.4%	29.8%	27.5%	28.4%	27.5%
Long-term debt/assets	3.0%	10.0%	23.0%	8.0%	7.6%	4.0%	3.9%	7.6%	6.9%	10.4%
PepsiCo, Inc.[b]										
Beverages, North America:										
Sales	1,065	2,368	2,725	5,035	7,427	6,171	9,146	—	—	—
Operating profit/sales	10.4%	10.3%	10.4%	13.4%	16.7%	22.3%	22.3%	—	—	—
Beverages, International:										
Sales	—	—	—	1,489	3,040	1,981	—	—	—	—
Operating profit/sales	—	—	—	6.3%	3.9%	8.0%	—	—	—	—
PepsiCo Americas Beverages:										
Sales	—	—	—	—	—	—	—	11,090	10,937	10,116
Operating profit/sales	—	—	—	—	—	—	—	22.4%	18.5%	21.5%
Consolidated:										
Sales	2,709	5,975	7,585	17,515	19,067	20,438	32,562	39,474	43,251	43,232
Net profit/sales	4.6%	4.4%	5.6%	6.2%	7.5%	10.7%	12.5%	14.3%	11.9%	13.8%
Net profit/equity	18.0%	20.0%	30.0%	22.0%	19.4%	30.1%	28.6%	32.8%	42.5%	35.4%
Long-term debt/assets	35.0%	31.0%	36.0%	33.0%	35.9%	12.8%	7.3%	12.1%	21.8%	18.6%

Source: Company annual reports and Capital IQ database, accessed June 2010.

[a] Beverage sales consist mainly of concentrate sales. Coke's stake in CCE was accounted for by the equity method of accounting, with its share of CCE's net earnings included in its consolidated net income figure. In 1994, Coke began reporting U.S. data as part of a North American category that included Canada and Mexico.

[b] PepsiCo's sales figures included sales by company-owned bottlers. In 1998, PepsiCo began reporting U.S. data as part of a North American category that included Canada. As of 2000, data for "Beverages, North America" combined sales for what had been the Pepsi-Cola and Gatorade/Tropicana divisions. In 2003, PepsiCo ceased reporting its international beverage business separately from its international food business. In 2007, Pepsi merged its North America beverage sales with Latin America sales, and started to report their combined financial under PepsiCo Americas Beverages.

Exhibit 3b Financial Data for Coca-Cola and PepsiCo's Largest Bottlers ($ millions)

	1975	1980	1985	1990	1995	2000	2005	2007	2008[a]	2009
Coca-Cola Enterprises[b] (CCE)										
Sales	—	—	—	3,933	6,773	14,750	18,743	20,936	21,807	21,645
Operating profit/sales	—	—	—	8.3%	6.9%	7.6%	7.6%	7.0%	-28.9%	7.1%
Net profit/sales	—	—	—	2.4%	1.2%	1.6%	2.7%	3.4%	-20.1%	3.4%
Net profit/equity	—	—	—	6.0%	5.7%	8.3%	14.0%	14.8%	NA	85.1%
Long-term debt/assets	—	—	—	39.0%	46.3%	46.7%	36.1%	30.7%	46.5%	48.1%
Pepsi Bottling Group (PBG)[c]										
Sales	—	—	—	—	—	7,982	11,885	13,591	13,796	13,219
Operating profit/sales	—	—	—	—	—	7.4%	8.6%	7.9%	4.7%	7.9%
Net profit/sales	—	—	—	—	—	2.9%	3.9%	3.9%	1.2%	4.6%
Net profit/equity	—	—	—	—	—	13.9%	22.8%	20.3%	12.1%	25.3%
Long-term debt/assets	—	—	—	—	—	42.3%	34.2%	36.4%	36.9%	40.5%

Source: Company annual reports.

[a] In 2008, CCE wrote off $7.6 billion to readjust the fair value of the company's intangible franchise assets and goodwill contracts, which resulted in a significant losses for the fiscal year. For more information, see "Notes to Consolidated Financial Statements" in CCE's 2008 annual report.

[b] Data represents CCE's consolidated financial data, as reported in CCE's annual reports, and does not reflect the combined financial data of the new CCE, following the sale of CCE's North America operations to Coke and CCE's purchase of Coke's bottling operations in Norway and Sweden. CCE's consolidated financial statements reflect wide fluctuations, affected by issues such as, but not limited to, debt write-offs, reassessments of franchise intangible assets to fair market value, and tax charges related to restructuring activities.

[c] PBG financial data for the pre-1999 period refer to the PepsiCo bottling operations that were combined and spun off to form PBG in 1998. From 1999, PepsiCo's share of PBG's net earnings was included in PepsiCo's consolidated net income figure. 2009's data does not reflect PepsiCo's purchase of PBG, as announced that year.

Exhibit 4 Comparative Costs of a Typical U.S. Concentrate Producer and Bottler, 2009

	Concentrate Producer		Bottler	
	Dollars per case[a]	Percent of net sales	Dollars per case[a]	Percent of net sales
Net sales	$0.98	100%	$4.63	100%
Cost of goods sold	$0.22	22%	$2.67	58%
Gross profit	$0.76	78%	$1.97	42%
Direct marketing expense	$0.21	21%	$0.45	10%
Selling & delivery expense	$0.00	0%	$0.85	18%
General & admin expense	$0.24	25%	$0.31	6%
Operating income	$0.30	32%	$0.36	8%

Sources: Compiled from estimates provided by beverage industry source, October 2010.

[a] One case is equivalent to 192 oz.

Exhibit 5 U.S. CSD Industry Pricing and Statistics, 1988-2009

	1988	1994	1998	2002	2006	2008	2009
Retail price per case, adjusted for inflation[a]	$10.79	$8.48	$7.63	$7.57	$7.47	$7.66	$7.98
Change in retail price[b]	—	-3.9%	-1.7%	-0.1%	-0.2%	0.4%	0.7%
Total Change 1988-2008:	**-1.4%**						
Concentrate price per case[c]	$0.79	$1.00	$1.14	$1.35	$1.50	$1.59	$1.65
Change in concentrate price	—	4.0%	3.3%	4.3%	2.7%	3.0%	3.8%
Total Change 1988-2009:	**3.6%**						
Volume (cases, in billions)	7.40	8.70	9.90	10.09	10.16	9.62	9.42
Change in volume	—	2.0%	3.3%	0.3%	0.2%	-2.7%	-2.1%
Total Change 1988-2009:	**1.2%**						
Consumption (gallons/capital)	40.30	50.00	54.00	52.60	51.10	47.40	46.00
Change in consumption	—	2.7%	1.9%	-0.4%	-0.7%	-3.7%	-3.0%
Total Change 1988-2009:	**0.6%**						
Consumer Price Index (2005=100)	60.57	75.91	83.48	92.11	103.22	110.23	109.88
Change in CPI	—	2.9%	2.4%	2.5%	2.9%	3.3%	-0.3%
Total Change 1988-2009:	**2.9%**						

Source: Compiled from *Beverage Digest Fact Book*, 2001, and every edition between 2006 and 2010.

[a] Refers to a 192-oz. case. Prices reflect inflation using the inflation calculator tool, U.S. Bureau of Labor Statistics website, http://data.bls.gov/cgi-bin/cpicalc.pl, accessed June 2010.

[b] All change figures are calculated using Compounded Annual Growth Rate (CAGR).

[c] For the purpose of this item only, concentrate price refers to a 288-oz. case. Concentrate price data for previous years appear in aggregated form in *Beverage Digest Fact Book* 2003, p. 64. After 2004, price is based on a weighted average of concentrate prices for the top 10 CSD brands, as released in *Beverage Digest Fact Book*, Appendix G, and based on the brands' market share for the given year. Concentrate prices were also affected by specific ingredients, such as corn and ethanol, which varied significantly from CPI in certain years.

Exhibit 6 U.S. Refreshment Beverages: Bottling Profitability per Channel, 2009

	Super-markets	Convenience retail	Super-centers[a]	Mass retailers[a]	Club stores[a]	Drug stores	Fountain, vending, and other	Total
Share of industry volume								
	37%	10%	11%	2%	7%	2%	31%	100%
Index of bottling profitability[b]								
Net price	1.00	2.24	1.13	1.10	0.93	1.23	2.09	NA
Variable profit	1.00	1.24	1.24	1.39	1.37	1.68	1.56	NA

Source: Compiled from estimates provided by beverage industry source, October 2010. All figures refer to the entire refreshment beverage industry.

[a] "Supercenters" include Wal-Mart Supercenter stories and similar outlets. "Mass Retailers" include standard Wal-Mart stores, Target stores, and the like. "Club Stores" include Sam's Club, Costco, and similar membership-based retailers.

[b] Using supermarket information as a baseline, these figures indicate variance by channel of both by-volume pricing and by-volume profit. The variable profit figures take into account cost of goods sold as well as delivery costs.

Exhibit 7 Non-Alcoholic Refreshment Beverage Megabrands, 2004 and 2009[a]

Brand (Owner)	Category	2009 Cases (mil)	2009 Share (%)	2004 Cases (mil)	2004 Share (%)	Annual Volume Change[b] 2004–09	Annual Change in Market Share[b] 2004–09
Coke (Coke)	CSD	2,913.1	19.6%	3,272.3	23.4%	-2.3%	-3.5%
Pepsi (Pepsi)	CSD	1,681.5	11.3%	2,098.4	15.0%	-4.3%	-5.5%
Mountain Dew (Pepsi)	CSD	900.1	6.1%	871.1	6.2%	0.7%	-0.3%
Dr Pepper (DPS)	CSD	784.0	5.3%	738.3	5.3%	1.2%	0.0%
Sprite (Coke)	CSD	573.0	3.9%	683.2	4.9%	-3.5%	-4.5%
Gatorade (Pepsi)	Non-Carb	553.7	3.7%	546.0	3.9%	0.3%	-1.0%
Aquafina (Pepsi)	Water	325.0	2.2%	251.0	1.8%	5.3%	4.1%
Dasani (Coke)	Water	289.7	1.9%	223.0	1.6%	5.4%	3.5%
Poland Spring (Nestlé Waters)	Water	280.1	1.9%	217.0	1.5%	5.2%	4.8%
7UP (DPS)	CSD	150.9	1.0%	186.7	1.3%	-4.2%	-5.1%
Minute Maid (Coke)	CSD/Non-Carb	95.5	0.6%	176.4	1.3%	-11.5%	-14.3%
Sierra Mist (Pepsi)	CSD	149.9	1.0%	166.9	1.2%	-2.1%	-3.6%
Lipton (Pepsi/Unilever)	Non-Carb	235.3	1.6%	164.0	1.2%	7.5%	5.9%
Crystal Geyser (CG Roxanne)	Water	223.7	1.5%	135.5	1.0%	10.5%	8.4%
Arrowhead (Nestlé Waters)	Water	156.4	1.1%	127.0	0.9%	4.3%	4.1%
PowerAde (Coke)	Non-Carb	177.6	1.2%	122.7	0.9%	7.7%	5.9%
Nestlé Pure Life (Nestlé Waters)	Water	469.4	3.2%	113.2	0.8%	32.9%	32.0%
Barq's (Coke)	CSD	103.7	0.7%	112.5	0.8%	-1.6%	-2.6%
Sunkist (DPS)	CSD	116.9	0.8%	105.2	0.8%	2.1%	0.0%

Source: Compiled from *Beverage Digest Fact Book 2005* and *2010;* and casewriter estimates.

[a] *Beverage Digest Fact Book* defines a "megabrand" as a "brand or trademark with total volume of more than 100 million 192-oz cases." A megabrand encompasses all varieties (Coke Classic, Diet Coke, Cherry Coke, and so on) of a given trademark ("Coke"). Only single-serve products are included here.

[b] All changes calculated using compounded annual growth rates.

Exhibit 8 Advertising Spending for Selected Refreshment Beverage Brands (in $ thousands)

	Market share[a]		Advertising spending[b]		Per 2009
	2009	2008	2009	2008	share point[c]
Coca-Cola	15.3%	15.2%	234,000	254,000	$15,294
Pepsi-Cola	8.8%	9.0%	136,000	145,000	$15,456
Mountain Dew	4.6%	4.5%	24,000	31,000	$5,217
Dr Pepper	4.1%	3.9%	76,000	64,000	$18,537
Gatorade	3.1%	3.6%	119,000	162,000	$38,387

Source: Created by casewriter based on "Special Report: 100 Leading National Advertisers," *Advertising Age*, June 21, 2010.

[a] Share of the total single-serve non-alcoholic beverage market. *Advertising Age*'s market share data may slightly differ from *Beverage Digest*'s data, seen in case Exhibit 2.

[b] Spending as measured across 19 national media channels using data tracked by Kantar Media and Kantar Media's Marx.

Exhibit 9 U.S. Non-CSDs Unit Case Volume (in millions)

	2002	2004	2006	2007	2008	2009
Packaged water	3,221.6	3,785.6	4,588.1	4,847.2	4,712.1	4,588.9
Juice & juice drinks	3,030.5	3,034.2	2,612.2	2,534.9	2,512.4	2,498.8
Sports drinks	488.1	620.5	912.3	950.4	856.9	843.3
Ready-to-drink tea	430.7	455.2	556.6	625.4	623.7	706.1
Energy drinks	28.9	63.7	135.3	177.0	217.3	218.0

Source: Compiled from estimates provided by beverage industry sources, September 2010. One case is equivalent to 192 oz.

Exhibit 10 Gross Profit Margins for Selected Beverages (%)

	Retail's gross margin	Brand's gross margin
Ready-to-drink coffee	35%	60%
Ready-to-drink tea	35%	60%
Energy	35%	70%
Sports	35%	65%
Juice	25%	35%
Water	35%	45%
CSD	30%	70%

Source: Compiled by casewriter using data from Marc Greenberg, "Coca-Cola Company Presentation" Deutsche Bank Securities Inc., April 12, 2010, p. 7.

Endnotes

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[2] See Exhibits 1, 3a, and 3b in this case.

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[7] Unless otherwise noted, information on industry participants and structures comes from Michael E. Porter (with research associate Rebecca Wayland), "Coca-Cola versus Pepsi-Cola and the Soft Drink Industry," HBS No. 391-179 (Boston: Harvard Business School Publishing, 1994); Andrew J. Conway et al., "Global Soft Drink Bottling Review and Outlook: Consolidating the Way to a Stronger Bottling Network", Morgan Stanley Dean Witter, August 4, 1997; and from casewriter interviews with industry executives.

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[21] Ibid, p.59. Market shares do not include duel outlets, such as those where Coke's pouring rights overlap with Dr Pepper's. If such outlets were included, Pepsi and DPS' market share would be higher.

[22] Ibid, p. 63.

[23] Casewriter examination of ingredients lists for Coke Classic and Pepsi-Cola, November 2005.

[24] Casewriter conversation with industry analyst, January 2006.

[25] *Beverage Digest Fact Book 2010*, p. 69.

[26] Ibid, p. 70.

[27] Unless otherwise attributed, all historical information in this section comes from J.C. Louis and Harvey Yazijian, *The Cola Wars* (Everest House, 1980); Mark Pendergrast, *For God, Country, and Coca-Cola* (Charles Scribner's, 1993); and David Greising, *I'd Like the World to Buy a Coke* (John Wiley & Sons, 1997).

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