Strategic Management
Session #1: Industry Analysis – The Cola Wars
Bernoulli goes to a bar and orders a Coke

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\[ \text{n choose } k = \binom{n}{k} = \frac{n!}{k!(n-k)!} \]

\[ n! = n(n-1)(n-2) \ldots \ast 1 \]

ROIC = EBIT/(Average invested capital – excess cash)

Source: Porter (HBR, 2008)
Average ROIC, 1992-2006

Source: Porter (HBR, 2008)
“Several times a year a weighty and serious investor looks with profound respect at Coca-Cola’s record, but comes regretfully to the conclusion that he is too late. The specter of saturation and competition rises before him.”

-- *Fortune* magazine (1938)
How the Carbonated soft drink industry works (simplified illustration)

Concentrate producers

Cola syrup in plastic canisters

Bottlers

Inputs

- Caramel coloring
- Phosphoric or citric acid
- Natural flavors
- Caffeine

- Blend syrup with sugar/corn syrup & water
- Fills up cans and bottles
Industry update

• March 2011, Diet Coke surpasses Pepsi and becomes #2 best-selling brand

• 2015: Coke 42.5%, Pepsi 27% market share (about the same as in 2009)

• Volume for the US carbonated drinks segment was down in 2016 (12th year of decline) to 8.6 billion cases

• Volume in 2016 ~ Volume in 1993

• But continued growth in non-CSDs
  • 2016 bottled water surpasses carbonated soft drinks
  • 2018: 42 gallons per capita of bottled water a year vs 37.5 gallons of CSD
However: Stock prices have been increasing (even though underperforming the S&P index, however dividends are not taken into account!)

Coke and Pepsi each pay >3% dividend per year; S&P average ~1.8%
... both are among the world’s largest and most valuable brands

Coca-Cola

Brand equity: $56.4 bn (#5 in 2017)
Market cap (04/2018) $187 bn

Pepsi

Brand equity: $18.2 bn (#30 in 2017)
Market cap (04/2018) $155 bn

New strategies ahead?

Source: https://www.forbes.com/powerful-brands/list/
Coke vs Pepsi continued

- Coke and Pepsi bought biggest bottlers (gain control) (2009, 2010)
- Coke to sell bottling plants and distribution again to focus on concentrate (2016)
- Both, Coke and Pepsi heavily diversified into complementary products
Key takeaways

- The concentrate industry is an example of a very attractive industry structure
  - All five competitive forces are mild (for most of the time)
  - Coke and Pepsi do not compete on price
  - Instead, they compete on dimensions that grow the industry, weaken customer power, raise barriers to entry, and make substitutes less powerful
  - Note some deterioration in structure since the late 1990s

- Example of how industry has been shaped by players
  - Soft drinks could have been an commodity product with low profitability
  - But the choices made by Coke and Pepsi created an industry with an extremely attractive structure
Industry Analysis

Adapted from Porter (2008)

**RIVALRY AMONG EXISTING COMPETITORS**

- Economies of scale
- Brand power
- Access to distribution
- Switching costs
- Capital Requirements
- Incumbency Advantage
- Government Policies
- Expected Retaliation

**BARGAINING POWER OF SUPPLIERS**

- Concentrated groups
- Suppliers are differentiated
- The supplier’s product is an important
- Suppliers can forward integrate

**THREAT OF NEW ENTRANTS**

- If they have negotiating leverage
- When they are price sensitive

**BARGAINING POWER OF BUYERS**

- Number of competitors
  (or few players equal in size and power)
- Lack of differentiation or switching costs
- Slow industry growth
- High fixed cost
- Perishable product
- High exit barriers

**THREAT OF SUBSTITUTES**

- High if: They offer an attractive price-performance trade-off to the industry product
- Buyer’s switching cost are low
The graph compares the Return on Invested Capital (ROIC) for Coca-Cola (Coke) and PepsiCo (Pepsi) from 2007 to 2016. The ROIC for both companies has shown a decline over the years, with Coca-Cola maintaining a slightly higher ROIC compared to Pepsi over the same period.

Source: Morningstar   http://financials.morningstar.com/
RoE per year (Coke vs Pepsi)


*2017 not included due to unusual tax-impact