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Cola Wars Continue: Coke and Pepsi in 2006

For more than a century, Coca-Cola and Pepsi-Cola vied for "throat share" of the world's beverage market. The most intense battles in the so-called cola wars were fought over the $66 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 cozy relationship began to fray in the late 1990s, however, as U.S. per-capita CSD consumption declined slightly before reaching what appeared to be a plateau. In 2004, the average American drank a little more than 52 gallons of CSDs per year. At the same time, the two companies experienced their own distinct ups and downs, as Coke suffered several operational setbacks and as Pepsi charted a new, aggressive course in alternative beverages. Although their paths diverged, however, both companies began to modify their bottling, pricing, and brand strategies.

As the cola wars continued into the 21st century, Coke and Pepsi faced new challenges: Could they boost flagging domestic CSD sales? Would newly popular beverages provide them with new (and profitable) revenue streams? Was their era of sustained growth and profitability coming to a close, or was this slowdown just another blip in the course of the cola giants' long, enviable history?

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**—U.S. Beverage Industry Consumption Statistics.) Fueling this growth were the increasing availability of CSDs and the introduction of diet and flavored varieties. Declining real (inflation-adjusted) prices played a large role as well.[4] There were many 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

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other beverage. Within the CSD category, the cola segment maintained its dominance, although its market share dropped from 71% in 1990 to 60% in 2004.[5] 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.[6]

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 little capital investment in machinery, overhead, or labor. A typical concentrate manufacturing plant cost about $25 million to $50 million to build, and one plant could serve the entire United States.[7]

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.[8]

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, Coca-Cola and Pepsi-Cola (the soft drink unit of PepsiCo) claimed a combined 74.8% of the U.S. CSD market in sales volume in 2004, followed by Cadbury Schweppes and Cott Corporation. (See **Exhibit 2**—U.S. Soft Drink Market Share by Case Volume. See also **Exhibit 3**—Financial Data for Coca-Cola, Pepsi-Cola, and Their Major Bottlers.) 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. In 2005, Cott completed construction of a 40-million-case bottling plant in Fort Worth, Texas, at an estimated cost of $40 million.[9] But the cost of a large plant with four lines, automated warehousing, and a capacity of 40 million cases, could range as high as $75 million.[10] While a handful of such plants could theoretically provide enough capacity to serve the entire United States, Coke and Pepsi each required close to 100 plants to provide effective nationwide distribution.[11] For bottlers, packaging accounted for 40% to 45% of the cost of sales, concentrate for roughly the same amount, and sweeteners for 5% to 10%. Labor and overhead made up the remaining variable costs.[12] Bottlers also invested capital in trucks and distribution networks. Bottlers' gross profits routinely exceeded 40%, but operating margins were usually in the 7% to 9% range. (See **Exhibit 4**—Comparative Costs of a Typical U.S. Concentrate Bottler and Producer.)

The number of U.S. soft drink bottlers had fallen steadily, from more than 2,000 in 1970 to fewer than 300 in 2004.[13] Coke was the first concentrate producer to build a nationwide franchised bottling network, and Pepsi and Cadbury Schweppes 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 2003, more than 88% of Coke's U.S. volume 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.[15] In 2002, for example, Coke contributed $600 million in marketing support payments to its top bottler alone.[16]

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).[17] From the 1980s to the early 2000s, concentrate makers regularly raised concentrate prices, even as inflation-adjusted retail prices for CSD products trended downward. (See **Exhibit 5**—U.S. CSD Industry Pricing and Volume Statistics.)

Franchise agreements with both Coke and Pepsi allowed bottlers to handle the non-cola brands of other concentrate producers. These agreements also allowed bottlers to choose whether to market new beverages introduced by a concentrate producer. 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 chose not to 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 2004, the distribution of CSDs in the United States took place through supermarkets (32.9%), fountain outlets (23.4%), vending machines (14.5%), mass merchandisers (11.8%), convenience stores and gas stations (7.9%), and other outlets (9.5%). Small grocery stores and drug chains made up most of the latter category.[18] Costs and profitability in each channel varied by delivery method and frequency, drop size, advertising, and marketing. (See **Exhibit 6—**U.S. Refreshment Beverages: Bottling Profitability Per Channel.)

The main distribution channel for soft drinks was the supermarket, where annual CSD sales reached $12.4 billion in 2004.[19] CSDs accounted for 5.5% of "the total edible grocery universe," and were also a big traffic draw for supermarkets.[20] 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 packaging types created intense competition for shelf space.

The mass merchandiser category included warehouse clubs and discount retailers, such as Wal-Mart. These companies formed an increasingly important channel. Although they sold Coke and Pepsi products, they (along with some drug chains) 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 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 had dominated 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, and CSD companies frequently sacrificed profitability in order to land and keep those accounts. As of 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%.[21] Local fountain accounts, which bottlers handled in most cases, were considerably more profitable than national accounts. Overall, according to a prominent industry observer, operating margins were 10 percentage points lower in fountain sales than in bottle and can sales.[22] To support the fountain channel, Coke and Pepsi invested in the development of service dispensers and other equipment, and provided fountain customers with cups, 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.[23] In 2005, Pepsi supplied all Taco Bell and KFC restaurants and the great majority of Pizza Hut restaurants, and Coke retained exclusivity 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.) And Coke continued to dominate the channel, with a 68% share of national pouring rights, against 22% for Pepsi and 10% for Cadbury Schweppes.[24]

Coke and Cadbury Schweppes 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. In the late 1990s, however, Pepsi began a successful campaign to gain from its bottlers the right to sell fountain syrup via restaurant commissary companies.[25]

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.[26] 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.[27] 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 2005, they represented 36.7% of CSD volume (and 56.7% of CSD revenues) in convenience stores.[28]

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 2005, major can producers included Ball, Rexam (through its American National Can subsidiary), and Crown Cork & Seal.[29] 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[30]

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.[31] 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.[32]

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).[33] 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.[34] 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."[35] 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.[36] 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, Shasta 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. (See **Appendix A**—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, to upgrade plant and equipment, and to support new product launches.[37] 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 to sell them to CCE.[38] "We became an investment banking firm specializing in bottler deals," said Don Keough. In 1997 alone, Coke put together more than $7 billion in such deals.[39] By 2004, CCE was Coke's largest bottler. It handled about 80% of Coke's North American bottle and can volume, and logged annual sales of more than $18 billion. Some industry observers questioned Coke's accounting practice with respect to CCE, since Coke retained substantial managerial influence in the putatively independent anchor bottler.[40]

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 2004, PBG produced 57% of PepsiCo beverages in North America and about 40% worldwide, while the total number of Pepsi bottlers had fallen from more than 400 in the mid-1980s to a mere 102.[41]

Bottler consolidation made smaller concentrate producers increasingly dependent on the Pepsi and Coke bottling networks for distribution of their products. In response, Cadbury Schweppes in 1998 bought and merged two large U.S. bottling companies to form its own bottler. In 2004, Coke had the most consolidated system, with its top 10 bottlers producing 94.7% of domestic volume. Pepsi's and Cadbury Schweppes' top 10 bottlers produced 87.2% and 72.9% of the domestic volume of their respective franchisors.[42]

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. Most notably, demand for its core product seemed to have leveled off. Although Americans still drank more CSDs than any other beverage, U.S. sales volume grew at a rate of 1% or less in the years 1998 to 2004. Total U.S. volume topped 10 billion cases in 2001, but had risen to only 10.2 billion cases in 2004. (A case was equivalent to 24 eight-ounce containers, or 192 ounces.) That was in contrast to annual growth rates of 3% to 7% during the 1980s and early 1990s.[43] Globally, too, demand remained flat. Worldwide volume in 2003 was 31.26 billion cases, which marked only a slight increase over the 1999 total of 31 billion cases. During that period, worldwide annual per-capita consumption declined from 125 eight-ounce servings to 119 servings.[44]

In responding to changing times, Coca-Cola struggled more than PepsiCo, in part because of its own internal difficulties and execution failures, and in part because of its greater reliance on a traditional CSD-oriented model. But, in their different ways, both companies sought to retain or

recapture their historically high growth and profitability within an apparently new environment. Toward that end, they focused on addressing challenges related to performance and execution, on providing alternative beverages to increasingly health-conscious consumers, on adjusting key strategic relationships, and on cultivating international markets.

Reversal of Fortune

When Coke CEO Robert Goizueta died unexpectedly in 1997, the company that he had led was at its zenith. During Goizueta's 16-year tenure, Coke's share price rose by 3,500%, and its brand was routinely deemed the most valuable in the world.[45] Pepsi, meanwhile, lagged behind its rival in most key measures of its beverage operations, including market share and sales growth.[46] By the middle of the following decade, however, Coke appeared to stumble from one embarrassment to another, while Pepsi was flying high.

Under the brief, rocky tenure of CEO Douglas Ivester (1997–1999), Coke lost a high-profile race-discrimination suit, underwent financial shocks caused by currency crises in Asia and Russia, and conducted the largest recall in its history after a contamination scare in Belgium. In the latter episode, there was no evidence of actual contamination; nonetheless, it was a public relations disaster.[47] Troubles continued under the next CEO, Douglas Daft (1999–2004). Layoffs of 7,000 employees from 2001 to 2004 cut Coke's work force by 20%—damaging morale and seriously weakening its executive ranks, many observers believed.[48] A contamination scare in India in 2003 hindered Coke's (as well as Pepsi's) push into a promising market, and a similar crisis in 2004 led the company to abort plans to roll out its Dasani water brand in Europe.[49] A series of legal problems burdened the company as well. In 2003, Coke agreed to pay Burger King $21 million following the revelation that it had rigged a marketing test involving the restaurant chain. That same year, the U.S. Justice Department and the Securities Exchange Commission (SEC) launched wide-ranging investigations of various Coke accounting practices, focusing on allegations of "channel stuffing." Under this practice, Coke pressured bottlers to buy excess concentrate in order to meet earnings targets. Coke in 2005 settled with the SEC on charges involving the Japanese market, but a shareholder suit alleging such practices in Europe, North America, and elsewhere remained in the courts.[50]

Coke also suffered from clumsy execution (or non-execution) of several initiatives. In 2001, it bailed out on a planned joint venture with Procter & Gamble. Around the same time, after two years of negotiation, it opted against buying the South Beach Beverage Co. (SoBe), only to watch Pepsi acquire that company. Similarly, in 2000 Coke allowed Pepsi to purchase Quaker Oats. Daft had agreed to buy Quaker for $15.75 billion, but several Coke directors halted the deal, arguing that the price was too high.[51] Coke installed a new CEO, E. Neville Isdell, in April 2004.[52] A 35-year Coke veteran, Isdell focused early in his tenure on regaining the company's lost luster as a high-performing soft drink maker. "We are not talking about radical change in strategy. We are talking about a dramatic change in execution," he said in November 2004.[53] Yet, at around the same time, he noted the need for Coke to take "corrective actions with a great urgency." During his first year as CEO, he committed to spending an additional $400 million per year on marketing and innovation, and on addressing Coke's "people deficit and skills deficit."[54]

While Coke struggled, Pepsi quietly flourished. In 2001, Steve Reinemund succeeded Roger Enrico as its CEO.[55] At a broad level, both men pursued the same simple strategy, which Reinemund couched in this way: "Grow the core and add some more."[56] Along with launching new CSDs, such as Sierra Mist (2000) and Mountain Dew Code Red (2001), Pepsi expanded into other beverage categories—an effort capped by its $14 billion acquisition of Quaker Oats, maker of Gatorade, in 2000.[57] Partly as a result, the company's North American beverage volume grew by 3% in 2004,

compared with virtually flat volumes for Coke.[58] As the world's fourth-largest food and beverage company, meanwhile, Pepsi also benefited from having a more diversified portfolio of products.

Financial returns for the two companies told a stark tale. Between 1996 and 2004, Coca-Cola logged an average annual growth in net income of 4.2%—a huge drop from the 18% average growth of the years 1990–1997. PepsiCo, by contrast, saw its net income rise by an average of 17.6% per year over the 1996–2004 period.[59] In 2003, Pepsi recorded a return on invested capital of 29.3%, up from 9.5% in 1996; for the first time in decades, it surpassed Coke in that measure.[60] From 1997 to 2004, Pepsi shareholders enjoyed a return of 46%, while Coke shareholders suffered a return of -26%.[61] (Coke shares, which reached a peak price of $89 in 1998, traded at half that amount in 2005.[62])

The Quest for Alternatives

Early in 2005, Pepsi announced that it would no longer set its marketing course by its regular cola brand. "We are treating Diet Pepsi as the flagship brand," said Dave Burwick, chief marketing officer for Pepsi-Cola North America. Although the marketing budget for regular Pepsi still exceeded that of the diet brand, the balance of attention and resources would now shift within the company.[63] More important, the move was a bellwether of a larger shift throughout the beverage industry. After several years of little or no growth in CSD sales—especially sales of regular, sugared sodas—companies responded aggressively to consumers' increasing demand for alternative beverages

New federal nutrition guidelines, issued in 2005, identified regular CSDs as the largest source of obesity-causing sugars in the American diet.[64] Schools in New York City, throughout California, and elsewhere banned the sale of soft drinks on their premises.[65] Late in 2005, using earlier actions against tobacco companies as a model, lawyers planned to file a suit against CSD makers for allegedly causing harm to children's health.[66] The American Beverage Association, an industry group, responded to such pressures by announcing rules to limit CSD sales in some schools. (In another noteworthy development, the ABA had changed its name from the National Soft Drink Association in 2004.)[67] But the widespread linkage of CSDs with obesity and other health-related concerns was hard to dispel from people's minds. From 2003 to 2004, according to a Morgan Stanley survey, the proportion of Americans who said that cola was "too fattening" increased from 48% to 59%.[68]

In such a climate, diet sodas offered one path to reviving sales. In the U.S. market, their share of total CSD volume grew from 24.6% in 1997 to 29.1% in 2004, thus making up for a decline in regular-soda consumption.[69] New or renamed products, such as Coca-Cola Zero (2005) and Sierra Mist Free (2004), targeted consumers—especially younger men—who shunned the "diet" label. With products like Pepsi One (2005) and Diet Coke with Splenda (2005), CSD makers sought to expand the diet market still further.[70]

But the search for alternatives centered on non-carbonated beverages, or "non-carbs"—a category that included juices and juice drinks, sports drinks, energy drinks, and tea-based drinks—and also on bottled water. In 2004, CSD volume in the United States grew by just 1%, whereas non-carb volume increased by 7.6% and single-serve bottled-water volume leaped by 18.8%. That year, CSDs accounted for 73.1% of U.S. non-alcoholic refreshment beverage volume (down from 80.8% in 2000), with the remaining volume made up of bottled water at 13.2% (up from 6.6% in 2000) and non-carbs at 13.7% (up from 12.6%).[71] In 2001, non-carbs and bottled water together contributed more than 100% of Coke's total volume growth and roughly three-fourths of Pepsi's volume growth.[72]

Pepsi was more aggressive than Coke in shifting to non-CSDs. "Politicians expect us to be on the defensive when we talk about health and wellness but we're not," said Pepsi CEO Reinemund. "It's a huge opportunity to build new brands and products."[73] His company launched a "Smart Spot"

program that labeled all products (including diet sodas and non-carbs) that met certain "good for you" criteria; in 2004, such products reportedly grew at twice the rate of other Pepsi food and beverage items.[74] Declaring itself to be a "total beverage company," Pepsi developed a portfolio of non-CSD products that outsold Coke's rival product in each key category: In 2004 volume sales, Gatorade (80.4%) led PowerAde (18.1%) in the $5.4 billion sports drink segment, Lipton (35.2%) led Nestea (23.9%) in the $3.2 billion tea-based drink segment, and Tropicana (26.8%) led Minute Maid (14.8%) in the $3.8 billion refrigerated juice segment. In the U.S. non-carb market overall (excluding bottled water), Pepsi had a market share of 47.3%, compared with Coke's share of 27.0%.[75]

Missed opportunities marked Coke's U.S. non-carb operations. In 2001, Coke acquired the Planet Java coffee-drink brand and the Mad River line of juices and teas; two years later, it folded both brands.[76] KMX, the company's entry in the fast-growing, $1.9 billion energy-drink segment, also foundered. Coke hoped for better luck with Full Throttle, introduced in 2005 to compete with segment leader Red Bull.[77] Observers noted Coke's continued focus on its traditional source of strength. "Regardless of what the skeptics think, I know carbonated soft drinks can grow," said Coke CEO Isdell.[78] In 2005, CSDs still accounted for 80% of Coke's worldwide beverage volume, while making up just two-thirds of Pepsi's volume.[79]

Coke fared better in the $11.4 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. (See **Exhibit 7**—Non-Alcoholic Refreshment Megabrands.) Using their distribution prowess, they had outstripped competing brands, many of which sold spring water. By 2004, Aquafina (13.6%) led the segment in market share, with Dasani (12.1%) trailing close behind.[80] Moreover, by arrangement with Danone, Coke handled U.S. marketing and distribution of that company's water brands, including Dannon and Evian. In 2004, Coke/Danone had an overall market share of 21.9%, behind market leader Nestlé Waters (42.1%) and ahead of Pepsi (13.6%). Coke bought out Danone's share of the venture in 2005.[81]

Evolving Structures and Strategies

Early in the 21st century, both Coke and Pepsi worked to improve "system profitability"—the arrangement whereby concentrate makers and their bottlers created and then divided overall profits from beverage sales. Bottler consolidation continued apace, and the relationship between Coke or Pepsi (on the one hand) and bottlers like CCE or PBG (on the other) became a key element of the cola wars. In the 1990s, a price war in the supermarket channel had highlighted a divergence of interest between the two camps. To compete against bargain private-label brands, bottlers had pursued a low-price strategy. Through the decade, retail CSD prices decreased or remained flat, even as the CPI inched up and as concentrate prices rose; Coke, for instance, raised its concentrate prices by 7.6% in 2000. Bottlers, already burdened by huge debts from consolidation and infrastructure investments, saw profit margins dwindle. In 1999 and 2000, they shifted course, as CCE increased its retail pricing in the supermarket channel by 6% to 7% and as PBG followed suit. Consumers balked, sales volume dipped, and concentrate makers saw their profits drop as a result.[82]

In later years, Coke struggled to adjust its relations with CCE and other bottlers—relations that one writer in 2004 called "dysfunctional."[83] In 2001, the company made an arrangement with CCE to link concentrate prices more tightly to CCE's wholesale CSD prices.[84] Starting in 2003, the two companies began negotiating a deal that would move toward "incidence pricing," an approach that Coke often used with its overseas bottlers. Under that system, concentrate prices varied according to prices charged in different channels and for different packages. As a rule, bottlers favored such arrangements in a deflationary market (which the CSD market had become) but resisted them in an inflationary market.[85] Isdell, Coke's new CEO in 2004 and a former bottler himself, emphasized the

need to improve bottler relations. Yet late that year, he tabled the CCE pricing initiative.[86] He also oversaw a proposed rise in concentrate prices that led Coca-Cola FEMSA, the Coke system's largest Mexican bottler, to threaten a cut in its marketing expenditure.[87]

Pepsi, observers noted, had less difficulty than Coke in aligning its strategy with that of its bottlers. "We believe PBG's relationship with PepsiCo is strong and has been critical to its success," one analysts' report asserted in 2003. During that period, PBG consistently posted net-revenue-per-case growth that exceeded CCE's growth by several percentage points. Supported by Pepsi, PBG excelled in higher-margin channels—especially the convenience-and-gas channel, in which the bottler actually led CCE. Bottlers profited immensely in such "immediate consumption" venues, where sales of the increasingly popular 20-oz PET bottle yielded margins as high as 35%, compared with the 5% to 7% margin on cans.[88]

All CSD companies faced the challenge of achieving pricing power in the take-home, or future-consumption, channels. Supermarket retail prices did rise, modestly but steadily, in the mid-2000s.[89] Yet retailers, accustomed to using CSD sales to drive in-store traffic, still resisted price increases.[90] Rapid growth of the mass-merchandiser channel, led by Wal-Mart and various club stores, posed a new threat to profitability for Coke, Pepsi, and their bottlers. By 2004, Wal-Mart was the largest U.S. food retailer; for PepsiCo, it represented 14% of the company's total (food and beverage) net revenue.[91] Such retailers used their size not only to exert pricing pressure; they also demanded that beverage companies alter longstanding business practices. Wal-Mart, for example, insisted on negotiating chain-wide marketing and shelving arrangements directly with concentrate makers. Although bottlers continued to handle deliveries to these accounts, relations between Coke or Pepsi and their bottlers underwent a great deal of stress because of this channel shift.[92]

To counter these pressures, CSD makers focused on enticing consumers through stepped-up marketing and innovation. In 2005, Coke combined authority for all of its marketing and product development in a new position that became the company's "de facto No. 2 spot."[93] It also launched a major advertising campaign, built around a new tag line: "The Coke Side of Life."[94] (See **Exhibit 8—**Advertisement Spending for Selected Refreshment Beverage Brands.) Packaging innovation received special emphasis. Coke in 2001 rolled out its Fridge Pack (later imitated by Pepsi, which introduced a Fridge Mate package), a reconfiguration of the standard 12-pack of cans that seemed to improve CSD sales.[95] In 2004, the company introduced a 1.5-liter bottle in select markets, aiming to replace the 2-liter version and thus to boost per-ounce pricing. While the launching of new products and packages brought clear benefits, it also increased costs for bottlers, which had to produce and manage an ever-rising number of stock-keeping units (SKUs).[96] (See **Exhibit 9—**Retailers' Assessment of Brand Performance.) That problem was most salient in the area of non-CSD beverages. The proliferation of such products, many of them sold in relatively low volume, led to an increasing 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 labor costs.

In general, alternative beverages complicated CSD makers' traditional production and distribution practices. CSD manufacturing was a cold-fill process. Some non-CSD beverages (such as Lipton Brisk) were also cold-fill products, and bottlers could adapt their infrastructure to those products with little difficulty. But other beverage types (such as Gatorade and Lipton Iced Tea) required costly new equipment and major process changes. More often than not, Coke and Pepsi took direct charge of manufacturing such beverages, which they then sold to their bottlers. The bottlers, in turn, distributed these finished goods alongside their own bottled products at a percentage markup. In others cases, especially that of bottled water, Coke and Pepsi paid for half or more of the cost of building bottling plants that allowed for filtration and other necessary processes. Bottlers then either purchased concentrate-like additives from the concentrate maker (as with Dasani's mineral packet) or

compensated Coke or Pepsi via per-unit royalty fees (as with Aquafina). In addition, Coke and Pepsi distributed some non-carbs (such as Gatorade) through food brokers and wholesalers, rather than through DSD delivery.[97]

These arrangements affected profitability in ways that were complex and evolving. With many non-carb beverages, especially energy drinks and sports drinks, high retail pricing and consumers' preference for immediate, single-serve consumption meant that margins were actually higher than they were for CSDs. Yet volume for such products, while growing fast, remained very small in comparison with CSD volume.[98] With bottled water, a different set of dynamics was in play. Here, sales volume soared (bottled water, one observer noted, was "the most frequent next stop for lapsed soft-drink users"[99]), and the cost, production, and distribution structures closely matched those of the traditional CSD industry. In the early 2000s, bottler margins on water were high; one research report estimated that a bottle of Pepsi's Aquafina garnered a profit of 22.4%, compared with a 19.0% profit for a bottle of Pepsi-Cola.[100] But as consumption shifted from single-serve to multi-pack options, pricing shifted accordingly. At some locations, at one point in 2002, a 24-bottle case of Dasani or Aquafina sold for $3.99, which was less than the cost of bottling it.[101] By 2006, according to one estimate, multi-serve products accounted for about 70% of the bottled water market, up from about 30% a decade earlier. Rising plastic costs also cut sharply into margins in this category.[102] In addition, compared with the CSD market, the water market appeared to involve low brand loyalty and high price sensitivity. A 2002 survey found that while 37% of respondents said that they chose a CSD because "it's my favorite brand," only 10% of respondents said so about a bottled water choice.[103]

Internationalizing the Cola Wars

As U.S. demand for CSDs reached an apparent plateau, Coke and Pepsi increasingly looked abroad for new growth. In 2004, the United States remained by far the largest market, accounting for about one-third of worldwide CSD volume. The next largest markets were, in order, Mexico, Brazil, Germany, China, and the United Kingdom.[104] But improved access to markets in Asia and Eastern Europe stimulated a new, intense phase of the cola wars. In many such markets, per-capita consumption levels were a small fraction of the level seen in the United States. For example, while the average American drank 837 eight-ounce cans of CSDs in 2004, the average Chinese drank just 21. Among major world regions, Coke dominated in Western Europe and much of Latin America, while Pepsi had a marked presence in the Middle East and Southeast Asia.[105] (See **Exhibit 10**—CSD Industry: Selected International Consumption Rates and Market Shares.) Although the growth potential of both established and emerging markets held great attraction, those markets also posed special challenges.

Coke flourished in international markets, and also relied upon them, far more than Pepsi. As far back as the end of World War II, the company had secured a position as the largest international producer of soft drinks. Coke steadily expanded its overseas operations in the following decades, and the name Coca-Cola became synonymous with American culture. By the early 1990s, Coke CEO Roberto Goizueta would note, "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."[106] Roughly 9 million outlets, located in more than 200 countries, sold Coke products in 2004.[107] About 70% of Coke's sales and about 80% of its profits came from outside the United States; only about one-third of Pepsi's beverage sales took place overseas.[108] Coke enjoyed a world market share of 51.4%, compared with 21.8% for Pepsi and 6% for Cadbury Schweppes.[109]

Pepsi entered Europe soon after World War II. Later, benefiting from Arab and Soviet exclusion of Coke, it moved into the Middle East and Soviet bloc. During the 1970s and 1980s, however, Pepsi put

relatively little emphasis on its overseas operations. By the early 1990s, the company once again attacked Coke in the latter's core international markets—though with relatively little success, since Coke struck back aggressively. In one high-profile skirmish, Pepsi's longtime bottler in Venezuela defected to Coke in 1996, temporarily reducing Pepsi's 80% share of the cola market there to nearly nothing.[110] Pepsi had moved away from bruising head-to-head competition with Coke by the early 2000s. Instead, it focused on emerging markets that were still up for grabs.[111] In 2004, its international division (which also covered food offerings) grew faster than any other division, and that division's operating profit was up by 25%. Its international beverage volume was up by 12% overall for the year, driven by a strong performance in its Asia Pacific (up 15%) and Europe, Middle East, and Africa (up 14%) divisions. For both CSDs and non-carbs, the company logged double-digit growth overseas, and double-digit growth also marked volume sales in China, India, and Russia.[112]

Both beverage giants encountered obstacles in their international operations, including antitrust regulation, price controls, advertising restrictions, foreign exchange controls, lack of infrastructure, cultural differences, political instability, and local competition. When Coke acquired most of Cadbury Schweppes's international CSD business in 1999, regulators in Europe, Mexico, and Australia barred the transaction from occurring in those markets.[113] In Germany, a 2003 bottle return law (later rescinded) led many retailers to stop carrying Coke and Pepsi products; for Coke, that disruption resulted in a year-over-year sales drop of 11%.[114] In Colombia, Marxist rebels in 2003 killed a local Coke executive in a bombing, while union activists accused the company of collaborating with right-wing death squads.[115] In many Latin American countries, low-cost upstarts like Peru's Kola-Real dented market share or eroded pricing power for the larger companies. In 2003, for example, these "B-brands" claimed 30% of CSD share in Brazil, up from about 3% in the early 1990s.[116]

Waging the cola wars in non-U.S. markets enabled Coke and Pepsi not only to expand revenue, but also to broaden their base of innovation. To cope with immature distribution networks, for example, they created novel systems of their own, such as Coke's network of vending machines in Japan—a high-margin channel that at one point accounted for more than half of the company's Japanese sales.[117] Japan also proved to be an impressive laboratory for new products. Teas, coffees, juices, and flavored water made up the majority of that country's 200-plus Coke items, and Coke's largest-selling product there was not soda but canned coffee. "If you're looking for a total beverage business we've got one in Japan," said Coke CEO Isdell.[118] During the same period, Coke introduced 20 new products with a health or diet emphasis into the Mexico market. New approaches to packaging abounded as well.[119] 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.[120]

The End of an Era?

In the early years of the 21st century, growth in soft drink sales for both Coke and Pepsi was falling short of precedent and of investors' expectations. Was the fundamental nature of the cola wars changing? Was a new form of rivalry emerging that would entail reduced profitability and stagnant growth—both inconceivable under the old form of rivalry? Or did the changes under way represent simply another step forward in the evolution of two of the world's most successful companies? In 2000, a Coke executive noted, "the cola wars are going to be played now across a lot of different battlefields."[121] What remained unclear in 2006 was whether those wars were still about "cola," and whether anyone knew for certain where those battlefields were located.

Exhibit 1 U.S. Beverage Industry Consumption Statistics

	1970	1975	1981	1985	1990	1994	1996	1998	2000	2002	2003	2004
Historical Carbonated Soft Drink Consumption												
Cases[a] (millions)	3,090	3,780	5,180	6,500	7,780	8,710	9,290	9,880	9,950	10,087	10,140	10,240
Gallons/capita	22.7	26.3	34.2	40.3	46.9	50.0	52.0	54.0	53.0	52.5	52.3	52.3
As share of total beverage consumption	12.4%	14.4%	18.7%	22.1%	25.7%	27.4%	28.5%	29.6%	29.0%	28.8%	28.7%	28.7%
U.S. Liquid Consumption Trends (gallons/capita)												
Carbonated soft drinks	22.7	26.3	34.2	40.3	46.9	50.0	52.0	54.0	53.0	52.5	52.3	52.3
Beer	22.8	21.8	20.6	24.0	24.0	22.4	21.8	21.8	21.8	21.8	21.7	21.6
Milk	18.5	21.6	24.3	25.0	24.2	23.0	22.7	22.0	21.3	20.7	20.4	20.1
Bottled water[b]	—	1.2	2.7	4.5	8.1	9.6	11.0	11.8	13.2	15.4	16.6	17.7
Coffee[c]	35.7	33	27.2	26.9	26.2	23.3	20.2	18.0	16.8	16.8	16.7	16.6
Juices	6.5	6.8	6.9	8.1	8.5	9.0	9.0	9.5	9.5	8.9	8.5	8.6
Tea[c]	5.2	7.3	7.3	7.3	7.0	7.1	6.9	6.9	7.0	7.0	7.0	7.0
Sports drinks[d]	—	—	—	—	—	1.2	1.5	1.9	2.2	2.6	3.0	3.5
Powdered drinks	—	4.8	6	6.2	5.4	4.8	4.8	3.7	3.0	2.4	2.5	2.6
Wine	1.3	1.7	2.1	2.4	2.0	1.7	1.8	1.9	1.9	2.0	2.1	2.1
Distilled spirits	1.8	2	2	1.8	1.5	1.3	1.2	1.2	1.2	1.3	1.3	1.3
Subtotal	114.5	126.5	133.3	146.5	153.8	153.3	152.2	152.7	150.9	151.4	152.1	153.4
Tap water/hybrids/all others	68	56	49.2	36.0	28.7	29.2	30.3	29.8	31.6	31.1	30.4	29.1
Total[e]	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: Compiled from *Beverage Digest Fact Book 2001*, *The Maxwell Consumer Report*, Feb. 3, 1994; *Adams Liquor Handbook*, casewriter estimates; and *Beverage Digest*, *Beverage Digest Fact Book 2005.* Data for 1990 and afterward comes from *Beverage Digest Fact Book 2005,* 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 Case Volume (percent)

	1966	1970	1975	1980	1985	1990	1995	2000	2004E
Coca-Cola Company									
Coke Classic	—	—	—	—	5.2	20.1	20.8	20.4	17.9
Coca-Cola	27.7	28.4	26.2	25.3	16.5	0.6	0.1	-	-
Diet Coke	—	—	—	—	6.8	9.3	8.8	8.7	9.7
Sprite and Diet Sprite	1.5	1.8	2.6	3.0	4.7	4.5	5.7	7.2	6.3
Caffeine Free Coke, Diet Coke, Tab	—	—	—	—	1.8	2.9	2.6	2.2	2.0
Fanta[a]	—	—	—	—	0.9	0.7	0.7	0.2	1.3
Barq's and Diet Barq's	—	—	—	—	—	—	0.2	1.2	1.2
Minute Maid brands	—	—	—	—	—	0.7	0.7	1.5	0.4
Tab	1.4	1.3	2.6	3.3	1.1	0.2	0.1	—	—
Others	2.8	3.2	3.9	4.3	2.5	2.1	2.6	2.6	4.3
Total	**33.4**	**34.7**	**35.3**	**35.9**	**39.5**	**41.1**	**42.3**	**44.1**	**43.1**
PepsiCo, Inc.									
Pepsi-Cola	16.1	17.0	17.4	20.4	19.3	17.6	15.0	13.6	11.5
Mountain Dew	1.4	0.9	1.3	3.3	3.1	3.9	5.7	7.2	6.3
Diet Pepsi	1.9	1.1	1.7	3.0	3.9	6.3	5.8	5.3	6.1
Sierra Mist	—	—	—	—	—	—	—	0.1	1.4
Diet Mountain Dew	—	—	—	—	—	0.5	0.7	0.9	1.3
Caffeine Free Pepsi, and Diet Pepsi	—	—	—	—	2.5	2.3	2.0	1.7	1.4
Mug Root Beer	—	—	—	—	—	0.3	0.3	0.8	0.7
Wild Cherry Pepsi (reg and diet)	—	—	—	—	—	—	0.2	0.5	0.6
Mountain Dew Code Red	—	—	—	—	—	—	—	—	0.4
Slice and Diet Slice	—	—	—	—	0.7	1.0	1.0	0.5	0.3
Others	1.0	0.8	0.7	1.1	0.8	0.5	0.2	0.8	1.7
Total	**20.4**	**19.8**	**21.1**	**27.8**	**30.3**	**32.4**	**30.9**	**31.4**	**31.7**
Cadbury Schweppes[b]									
Dr Pepper (all brands)	—	—	—	—	—	—	6.8	7.5	7.2
7UP (all brands)	—	—	—	—	—	—	3.3	2.8	1.8
A&W brands	—	—	—	—	—	—	1.7	1.5	1.4
Royal Crown brands	—	—	—	—	—	—	—	—	1.1
Sunkist	—	—	—	—	1.2	0.7	0.7	0.8	1.0
Canada Dry	—	—	—	—	1.5	1.2	1.0	0.9	0.8
Schweppes	—	—	—	—	0.5	0.6	0.5	0.4	0.4
Others	—	—	—	—	1.5	0.7	1.1	0.8	0.8
Total					**4.7**	**3.2**	**15.1**	**14.7**	**14.5**
Dr Pepper/Seven-Up Cos.[c]									
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	—	—	—	—	—	0.5	—	—	—
Total						**9.6**	—	—	—
Cott Corporation	—	—	—	—	—	—	2.7	3.3	5.5
Royal Crown Cos.	**6.9**	**6.0**	**5.4**	**4.7**	**3.1**	**2.6**	**2.0**	**1.1**	—
Other companies	**29.8**	**28.5**	**25.1**	**19.3**	**12.1**	**11.1**	**7.0**	**5.4**	**5.2**
Total case volume (in millions)[d]	**2,927**	**3,670**	**4,155**	**5,180**	**6,385**	**7,780**	**8,970**	**9,950**	**10,240**

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

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

[b] Cadbury Schweppes acquired A&W brands in 1993, Dr Pepper/Seven-Up Cos. (DPSU) brands in 1995, and Royal Crown brands in 2000.

[c] Dr Pepper/Seven-Up Companies (DPSU) was formed in 1988. 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.

[d] One case is equivalent to 192 oz.

Exhibit 3 Financial Data for Coca-Cola, Pepsi-Cola, and Their Largest Bottlers ($ millions)

	1975	1980	1985	1990	1995	2000	2001	2002	2003	2004
Coca-Cola Company[a]										
Beverages, North America										
Sales	—	1,486	1,865	2,461	5,513	7,870	7,526	6,264	6,344	6,643
Operating profits/sales	—	11.1%	11.6%	16.5%	15.5%	17.9%	19.7%	23.9%	18.9%	24.2%
Beverages, International										
Sales	—	2,349	2,677	6,125	12,559	12,588	12,386	13,089	14,477	15,076
Operating profit/sales	—	21.0%	22.9%	29.4%	29.1%	27.1%	37.1%	35.8%	33.3%	33.6%
Consolidated										
Sales	2,773	5,475	5,879	10,236	18,127	20,458	20,0092	19,564	21,044	21,962
Net profit/sales	9.0%	7.7%	12.3%	13.5%	16.5%	10.6%	19.8%	15.6%	20.7%	22.1%
Net profit/equity	21.0%	20.0%	24.0%	36.0%	55.4%	23.4%	34.9%	25.8%	30.9%	30.4%
Long-term debt/assets	3.0%	10.0%	23.0%	8.0%	7.6%	4.0%	5.4%	11.0%	9.2%	3.7%
PepsiCo, Inc.[b]										
Beverages, North America										
Sales	1,065	2,368	2,725	5,035	7,427	6,171	6,888	7,200	7,733	8,313
Operating profit/sales	10.4%	10.3%	10.4%	13.4%	16.7%	22.3%	21.3%	21.9%	21.9%	23.0%
Beverages, International										
Sales	—	—	—	1,489	3,040	1,981	2,012	2,036	—	—
Operating profit/sales	—	—	—	6.3%	3.9%	8.0%	10.5%	12.8%	—	—
Consolidated										
Sales	2,709	5,975	7,585	17,515	19,067	20,438	26,935	25,112	26,971	29,261
Net profit/sales	4.6%	4.4%	5.6%	6.2%	7.5%	10.7%	9.9%	13.2%	13.2%	14.4%
Net profit/equity	18.0%	20.0%	30.0%	22.0%	19.4%	30.1%	30.8%	35.6%	30.0%	31.0%
Long-term debt/assets	35.0%	31.0%	36.0%	33.0%	35.9%	12.8%	12.2%	9.3%	6.7%	
Coca-Cola Enterprises (CCE)										
Sales	—	—	—	3,933	6,773	14,750	15,700	16,889	17,330	18,158
Operating profit/sales	—	—	—	8.3%	6.9%	7.6%	4.3%	8.0%	8.6%	7.9%
Net profit/sales	—	—	—	2.4%	1.2%	1.6%	-2.0%	2.9%	3.9%	3.3%
Net profit/equity	—	—	—	6.0%	5.7%	8.3%	-11.5%	14.9%	15.5%	11.1%
Long-term debt/assets	—	—	—	39.0%	46.3%	46.7%	43.7	46.1%	41.1%	39.9%
Pepsi Bottling Group (PBG)[b]										
Sales	—	—	—	—	—	7,982	8,443	9,216	10,265	10,906
Operating profit/sales	—	—	—	—	—	7.4%	8.0%	9.7%	9.3%	9.0%
Net profit/sales	—	—	—	—	—	2.9%	3.6%	4.6%	4.1%	4.2%
Net profit/equity	—	—	—	—	—	13.9%	19.1%	23.5%	22.1%	23.4%
Long-term debt/assets	—	—	—	—	—	42.3%	41.8%	45.1%	38.9%	41.6%

Source: Company annual reports.

[a] Coca-Cola's beverage sales consisted 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. 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.

Exhibit 4 Comparative Costs of a Typical U.S. Concentrate Producer and Bottler, 2004

	Concentrate Producer		Bottler	
	Dollars per Case[a]	Percent of Sales	Dollars per Case[a]	Percent of Sales
Net sales	$0.97	100%	$4.70	100%
Cost of sales	$0.16	17%	$2.82	60%
Gross profit	$0.81	83%	$1.88	40%
Selling and delivery	$0.02	2%	$1.18	25%
Advertising and marketing	$0.42	43%	$0.09	2%
General and administration	$0.08	8%	$0.19	4%
Pretax profit	$0.29	30%	$0.42	9%

Sources: Industry analysts and casewriter estimates. Profit and loss percentage data are adapted 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, and supplemented with 2004 data supplied by Corey Horsch, of Credit Suisse First Boston.

[a] One case is equivalent to 192 oz.

Exhibit 5 U.S. CSD Industry Pricing and Volume Statistics, 1998–2004

	1988	1990	1992	1994	1996	1998	2000	2002	2004
Retail price per case[a]	$8.78	$8.99	$8.87	$8.63	$8.70	$8.55	$9.08	$9.38	$9.68
Change in retail price[b]	—	1.2%	-0.7%	-1.4%	0.4%	-0.9%	3.1%	1.6%	1.6%
Total Change 1988–2004: 0.6%									
Concentrate price per case[a]	$0.79	$0.86	$0.97	$1.00	$1.07	$1.14	$1.29	1.35	1.45[c]
Change in concentrate price	—	4.3%	6.2%	1.5%	3.4%	3.2%	6.4%	2.3%	3.6%
Total Change 1988–2004: 3.9%									
Volume (cases, in billions)[a]	4.9	5.2	5.3	5.8	6.2	6.6	6.6	6.7	6.8
Change in volume	—	3.0%	1.0%	4.6%	3.4%	3.2%	0.0%	0.8%	0.7%
Total Change 1988–2004: 2.1%									
Consumption (gallons/capita)	40.3	46.9	47.2	50.0	52.0	54.0	53.0	52.5	52.3
Change in consumption	—	7.9%	0.3%	2.9%	2.0%	1.9%	-0.9%	-0.5%	-0.2%
Total Change 1988–2004: 1.6%									
Consumer Price Index[d]	100	110	119	125	133	138	146	152	160
Change in CPI	—	5.1%	3.6%	2.8%	2.9%	1.9%	2.8%	2.0%	2.6%
Total Change 1988–2004: 3.0%									

Source: Compiled from *Beverage Digest Fact Book 2001* and *Beverage Digest Fact Book 2005*, and using the Inflation Calculator tool, U.S. Bureau of Labor Statistics website, http://data.bls.gov/cgi-bin/cpicalc.pl, accessed November 2005.

[a] For the purposes of this exhibit only, "case" refers to a 288-oz case.

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

[c] Concentrate price for 2004 is based on a weighted average of concentrate prices for the top 10 CSD brands. Concentrate price data for previous years appear in aggregated form in *Beverage Digest Fact Book 2003*, p. 64.

[d] CPI data use 1988 as the index year (1988 = 100).

Exhibit 6 U.S. Refreshment Beverages: Bottling Profitability per Channel, 2005

	Super-markets	Convenience and Gas	Super-centers[a]	Mass Retailers[a]	Club Stores[a]	Drug Stores	Fountain and Vending	Total
Share of industry volume[b]								
	31%	15%	9%	4%	4%	3%	34%	100%
Index of bottling profitability[c]								
Net Price	1.00	1.54	0.95	1.08	1.07	1.19	1.48	NA
Variable Profit	1.00	1.86	0.90	1.17	0.81	1.31	1.80	NA

Source: Compiled from estimates provided by beverage industry source, April 2006.

[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] Figures here and below refer to the entire refreshment beverage industry, encompassing CSD and non-carb beverage volume.

[c] 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[a], 2004 and 2000

Brand (Owner)	Category	2004 Cases (mil)	2004 Share	2000 Cases (mil)	2000 Share	Annual Volume Change[b] 2000–04	Annual Share Change[b] 2000–04
Coke (Coke)	CSD	3,272.3	23.4%	3,192.6	25.9%	0.6%	-2.5%
Pepsi (Pepsi)	CSD	2,098.4	15.0%	2,159.9	17.5%	-0.7%	-3.8%
Mountain Dew (Pepsi)	CSD	871.1	6.2%	809.8	6.6%	1.8%	-1.5%
Dr Pepper (Cadbury)	CSD	738.3	5.3%	747.5	6.1%	-0.3%	-3.5%
Sprite (Coke)	CSD	683.2	4.9%	713.0	5.8%	-1.1%	-4.1%
Gatorade (Pepsi)	Non-Carb	546.0	3.9%	325.0	2.6%	13.9%	10.7%
Aquafina (Pepsi)	Water	251.0	1.8%	100.7	0.8%	25.7%	22.5%
Dasani (Coke)	Water	223.0	1.6%	65.1	0.5%	36.0%	33.8%
Poland Spring (Nestlé Waters)	Water	217.0	1.5%	91.8	0.7%	24.0%	21.0%
7UP (Cadbury)	CSD	186.7	1.3%	276.1	2.2%	-9.3%	-12.3%
Minute Maid (Coke)	CSD/Non-Carb	176.4	1.3%	145.0	1.2%	5.0%	2.0%
Sierra Mist (Pepsi)	CSD	166.9	1.2%	—	—	—	—
Lipton (Pepsi/Unilever)	Non-Carb	164.0	1.2%	155.2	1.3%	1.4%	-2.0%
Crystal Geyser (CG Roxanne)	Water	135.5	1.0%	50.2	0.4%	28.2%	25.7%
Arrowhead (Nestlé Waters)	Water	127.0	0.9%	46.6	0.4%	28.5%	18.9%
PowerAde (Coke)	Non-Carb	122.7	0.9%	62.6	0.5%	18.3%	15.9%
Nestlé Pure Life (Nestlé Waters)	Water	113.2	0.8%	—	—	—	—
Barq's (Coke)	CSD	112.5	0.8%	121.2	1.0%	-1.8%	-5.4%
Sunkist (Cadbury)	CSD	105.2	0.8%	80.3	0.7%	7.0%	3.4%

Source: Compiled from *Beverage Digest Fact Book 2005; Beverage Digest Fact Book 2001*; 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 Rate (CAGR).

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

	Share of market[a]		Advertisement Spending[b]		
	2004	2003	2004	2003	per 2004 share point
Coca-Cola	23.4%	24.3%	246,243	167,675	10,523
Pepsi-Cola	15.0%	15.5%	211,654	236,396	14,110
Mountain Dew	6.2%	6.4%	57,803	60,555	9,323
Dr Pepper	5.3%	5.3%	104,762	96,387	19,766
Sprite	4.9%	5.3%	45,035	31,835	9,191
Gatorade	3.9%	3.5%	141,622	130,993	36,313
Aquafina	1.8%	1.7%	22,037	24,647	12,243
Dasani	1.6%	1.5%	17,633	18,833	11,021
7UP	1.3%	1.5%	34,608	25,071	26,206
Minute Maid	1.3%	1.5%	35,797	21,097	27,228
Sierra Mist	1.2%	1.2%	60,327	64,129	50,273
PowerAde	0.9%	0.8%	11,008	10,100	12,231

Source: Compiled from "Special Report: 100 Leading National Advertisers," *Advertising Age*, June 27, 2005, and casewriter estimates.

[a] Share of the total single-serve non-alcoholic beverage market (about 14 billion cases in 2004).

[b] Spending as measured across 17 national media channels using data compiled by TNS Media Intelligence.

Exhibit 9 Retailers' Assessment of Brand Performance, 2004

	Top 6 Brands[a]					
	P&G	**Kraft**	**Gen'l Mills**	**Pepsi-Cola**	**Coca-Cola**	**Unilever**
Brands most important to retailers	57.1%	47.3%	19.8%	15.8%	13.7%	11.8%
	Kraft	**P&G**	**Gen'l Mills**	**Nestle**	**Con-Agra**	**Pepsi-Cola**
Best combination of growth, profitability	33.3%	27.6%	26.3%	13.6%	12.5%	11.2%
	Kraft	**P&G**	**Gen'l Mills**	**Pepsi-Cola**	**Nestle**	**Frito-Lay**
Best sales force/customer teams	32.7%	31.5%	26.4%	14.1%	13.9%	8.4%
	P&G	**Kraft**	**Gen'l Mills**	**Pepsi-Cola**	**Coca-Cola**	**Unilever**
Most innovative marketing programs	30.7%	29.6%	28.9%	14.7%	13.4 %	12.7%
	P&G	**Kraft**	**Gen'l Mills**	**Nestle**	**Pepsi-Cola**	**Coca-Cola**
Most helpful customer information	50.3%	27.2%	23.1%	13.1%	9.4%	9.1%
	P&G	**Kraft**	**Gen'l Mills**	**Nestle**	**Campbell's**	**Unilever**
Best supply chain management	55.0%	36.9%	25.9%	15.9%	10.2%	8.8%

Source: Cannondale Associates, PoweRanking Survey®, 2004.

[a] Each brand measured by percentage of respondents who rank the brand first, second, or third for each category.

Exhibit 10 CSD Industry: Selected International Consumption Rates and Market Shares, 2003 and 1999

	Population	Consumption (8-oz servings per capita)		Annual Growth[a]	2003 Share			1999 Share		
	(thousands)	2003	1999	1999-2003	Coke	Pepsi	Cadb'ry	Coke	Pepsi	Cadb'ry
Europe (23.4%)										
Germany	82,476	340	344	-0.3%	51	5	1	56	8	1
United Kingdom	59,251	420	370	3.2%	47	11	0	43	12	0
Spain	41,060	425	386	2.4%	65	15	5	60	16	5
Italy	57,423	216	212	0.5%	44	6	1.5	45	8	1
France	60,144	180	158	3.3%	60	6	18.6	60	8	5
Russia	143,246	70	52	7.7%	21	18	0	26	12	0
Poland	38,587	167	155	1.9%	19	15	1	28	17	1
Netherlands	16,149	335	356	-1.5%	80	14	0	45	15	1
Hungary	9,877	279	273	0.5%	49	25	4	57	29	5
Romania	22,334	145	104	8.7%	46	8	0	44	9	0
Czech Republic	10,236	410	215	17.5%	13	7	1	36	13	2
Latin America (24.3%)										
Mexico	103,457	610	590	0.9%	73	20	5.1	70	19	3
Brazil	178,470	312	276	3.1%	46	7	0	51	7	0
Argentina	38,428	400	374	1.7%	50	19	0	59	24	0
Colombia	44,222	159	181	-3.2%	51	11	0	60	8	0
Venezuela	25,699	205	290	-8.3%	49	21	0	70	30	0
Chile	15,805	402	392	0.6%	73	5	0	81	4	0
Peru	27,167	166	108	11.4%	39	9	0	50	16	0
Asia Pacific (13.6%)										
China	1,304,196	21	22	-1.2%	51	24	0	34	16	0
Philippines	79,999	187	205	-2.3%	80	16	0	70	18	0
Japan	127,654	80	92	-3.4%	64	11	0	55	11	0
Australia	19,731	490	502	-0.6%	56	10	18.5	57	10	16
Thailand	62,833	95	114	-4.5%	56	43	0	52	45	0
India	1,065,462	8	6	7.5%	45	43	0	56	44	0
South Korea	47,700	118	108	2.2%	47	17	0	54	13	0
Indonesia	219,883	14	9	11.7%	75	5	0	94	6	0
Pakistan	153,578	24	14	14.4%	26	73	0	25	71	3
Vietnam	81,377	20	15	9.3%	39	34	0	63	36	0
Africa/Middle East (7.8%)										
South Africa	45,026	218	207	1.3%	94	0	0	97	0	0
Saudi Arabia	24,217	270	229	4.2%	15	82	0	24	76	0
Egypt	71,931	61	50	5.1%	48	42	0	60	40	0
Israel	6,433	452	400	3.1%	55	11	0	70	14	0
Morocco	30,566	56	63	-2.9%	87	3	8	96	4	0
North America										
United States	290,809	837	874	-1.1%	44	31	14	44	31	15
Canada	31,510	463	489	-1.4%	38	37	9	39	35	9
Total Worldwide	6,305,252	119	125	-1.2%	51	22	6	53	21	6

Sources: Compiled from *Beverage Digest Fact Book 2005* and *Beverage Digest Fact Book 2001*.

[a] Change calculated using Compounded Annual Growth Rate (CAGR).

[b] Share of worldwide market by volume.

Appendix A Cadbury Schweppes: Operations and Financial Performance

By the late 1990s, Cadbury Schweppes had emerged as the clear, albeit distant, third-largest player in the U.S. soft drink industry. Its products accounted for 14.5% of CSDs and 9.3% of non-carbs sold in 2004. Its brands include Dr Pepper, 7UP, RC Cola, Schweppes, Canada Dry, A&W, Squirt, Sundrop, Welch's, Country Time, Clamato, Hawaiian Punch, Snapple, Mistic, and Stewart's.

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 drink 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 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 Mistic and Snapple brands in 2001 more than doubled its non-carb market from 6.0% in 1999. Further acquisitions included the Orangina and Yoo-Hoo brands (bought from Pernod Ricard in 2001), Squirt (a top-selling brand in Mexico, purchased in 2002), and Nantucket Nectars (bought in 2002 and folded into the Snapple brand). In 1999, Cadbury Schweppes disposed of its soft drink brands in around 160 countries, concentrating its beverages interests on North America, Europe, and Australia.

In 2004, Cadbury Schweppes operated primarily as a licensor, selling concentrate and syrup to independently owned bottling and canning operations (some of which were affiliated with competitors) It also provided marketing support and technical manufacturing oversight to these companies. In the United States, Cadbury Schweppes had a 40% interest in the Dr Pepper/Seven Up Bottling Group (DPSUBG), which accounted for 28.7% of its CSD volume. With its non-carb products and in certain markets (particularly Mexico), it manufactured and distributed its beverages directly or through third-party bottlers.

Table A Cadbury Schweppes Financial Data ($ millions)

	2004	2003	2002	2001	2000
Americas Beverages					
Sales	$3,854	$3,239	$3,190	$2,770	$1,950
Operating profits/sales	25.2%	29.3%	29.5%	29.7%	32.7%
Europe Beverages[a]					
Sales	$1,253	$1,236	$882	$560	$477
Operating profit/sales	17.9%	17.3%	19.0%	18.2%	15.4%
Consolidated[b]					
Sales	$12,927	$11,500	$8,528	$7,220	$6,161
Operating margin	13.6%	11.6%	17.4%	17.9%	18.9%
Return on assets	5.2%	3.9%	7.0%	7.6%	8.4%

Source: Company financial reports; OneSource, Global Business Browser, http://globalbb.onesource.com/web/Reports/cia.aspx?KeyID=L5018&Process=CP, accessed November 2005

[a] Soft 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.

[b] Consolidated figures include worldwide confectionary sales.

Endnotes

[1] *Beverage Digest Fact Book 2005*, p. 14.

[2] See Exhibit 1 and Exhibit 3 in this case.

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

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

[5] *Beverage Digest Fact Book 2005*, p. 45.

[6] 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" (analysts' report), Morgan Stanley Dean Witter, August 4, 1997; and from casewriter interviews with industry executives.

[7] Casewriter conversation with industry insider, April 2006.

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Coke and Pepsi built a nationwide bottling network where a bottler exclusively owned the manufacturing and sales operation in their specific territory. The consumerâ€™s preference shift to non-CSDâ€™s forced the companies to change their traditional production and distribution processes. Concentrate companies became more directly involved in manufacturing non-CSDâ€™s, however, this was not the case for the bottlers.Â Works Cited Yoffie, David B., and Renee Kim. "Cola Wars Continue: Coke and Pepsi in 2010.â€ Harvard Business School Case 706-447, 2006 (Revised May 2011.) Daft, Richard (2012). Management (11th ed). Maso, OH: Thomson-Southwestern. ! Related Papers. 9 -7 1 1 -462 Cola Wars Continue: Coke and Pepsi in 2010. By Anh Tran. Coca-Cola and Pepsi-Cola had vied for the "throat share" of the world's beverage market. The most intense battles of the cola wars were fought over the $66 billion CSD industry in the United States, where the average American consumes 52 gallons of CSD per year. In a "carefully waged competitive struggle," from 1975 to 1995, both Coke and Pepsi had achieved average annual growth of around 10%, as both U.S. and worldwide CSD consumption consistently rose. This cozy situation was threatened in the late 1990s, however, when U.S. CSD consumption declined slightly before re