Porter’s Five Forces Analysis

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| **Factor**  *Click a factor to learn more* | **Rank**  *High, Medium, Low* | **Data/ Evidence**  *Add data/evidence to support your ranking* |
| **[Barriers to Entry](#Def_Barriers_to_entry" \o "This force determines how easy it is for a company to enter into a particular industry. The higher the barriers to entry the more difficult it is for a new firm to enter the industry and therefore the lower the Threat of New Entrants.  )** |  |  |
| [Economies of Scale and Scope](#Def_EconomiesofScale_andScope" \o "Economies of scale exist when a firm’s costs fall as a function of its volume of production where greater amounts of product lead to lower costs.) | Medium | In the soft drink industry, a developed company such as PepsiCo has the advantage of being able to keep costs down with their extensive distribution and bottling networks. As PepsiCo continues to produce and distribute in bulk, they are able to keep costs down and increase profit margins. New entrants to the market wouldn’t be able to compete with the established production process that PepsiCo and other firms already have established. However, Coke is still the market leader in this industry so there is room to develop.[[1]](#footnote-1) |
| [Capital Requirements and High Sunk Costs](#Def_CapitalRequirements_HighSunkCosts" \o "Capital requirements are the initial cost of trying to enter into this industry and high sunk costs mean costs that have already been spent and cannot be recovered.) | Low | Producing the actual soft drinks is rather cheap to do for new companies. But marketing and advertisements is highly expensive for soft drink companies. PepsiCo alone spends $2.5 Billion in 2016 on advertising expenses worldwide.[[2]](#footnote-2) PepsiCo is already established in this area which makes this barrier beneficial for them. |
| Customer Loyalty | Low | In the soft drink industry brand loyalty plays a large rule in companies’ profits and market share. Forbes published an article that Pepsi had recently overtaken Coke to become the leader in soda brand loyalty. [[3]](#footnote-3) Through heavy marketing to connect with younger consumers Pepsi now has an advantage that would be difficult for Coke to reclaim. For new soda companies it would take years and a large investment to establish a loyal customer base. |
| Network Effects | Low | Network effects come in to play when more people are drinking Pepsi than this benefits consumers, because more Pepsi products will be supplied and manufactured. For small companies coming into this industry it would be near impossible to establish strong network effects.[[4]](#footnote-4) |
| [Government Policy and Regulation](#Def_GovernmentPolicy_andRegulation" \o "Are there certain restrictions, laws, or regulations that make it difficult to enter the industry?) | Medium | Patents prevent new companies from copying recipes for products.[[5]](#footnote-5) Therefor companies would be forced to develop their own flavor, name, and brand image. This helps in keeping out smaller companies that would threaten PepsiCo’s market share. |
| [Reputation](#Def_Reputation" \o "Do the companies currently in the industry have a reputation or brand image that make it difficult to enter the industry? Is that brand image important?) | Low | Consumers look to purchase products that are recognizable. Reputation and brand recognition highly influences consumer’s purchasing decisions. In addition to this PepsiCo has a good reputation as being environmental, which is highly impressive for a company that is known for offering unhealthy products.[[6]](#footnote-6) |
| [Buyer Switching Costs](#Def_BuyerSwitchingCosts" \o "Does it cost any resources for the buyer to switch from their current company to switch to your company?) | Low | Soft drink products all have very similar pricing. Switching cost are incremental, so products are chosen on preference of taste not based on prices.[[7]](#footnote-7) This is beneficial for PepsiCo, because consumers of separate products will have minimum restrictions from allowing them to try PepsiCo products. |
| [Access to Distribution Channels](#Def_Accessto_DistributionChannels" \o "Is there easy access to retailers or other distribution channels to distribute your product?) | Low | Products are easily distributed through retailers, vending machines, and restaurants throughout over 200 countries.[[8]](#footnote-8) PepsiCo already has a highly efficient distribution scheme that would impossible for a new entry to the market to copy. |
| [Exit Barriers](#Def_Exit_Barriers" \o "Is it hard to leave the industry once you enter the market?) | Low | It is easy for companies in this industry to exit, because they would merely have to sell-off their existing assets to any companies that are remaining. Products that are offered are also non-perishable for the most part, so while the company can stop production they can continue to sell the remainder of their products.[[9]](#footnote-9) |
| **[Supplier Power](#Def_Supplier_Power" \o "This force determines how much leverage the supplier has in your industry in terms of quality, price, or other factors.)** |  |  |
| [What are they?](#Def_What_are_they" \o "What are the inputs you need from suppliers and which companies supply them? Are they mostly raw materials that are commodities (easy to find/purchase) or rare diamonds.) | Low | Raw Materials used in producing and packaging that are easily accessible such as sugar, water, carbon dioxide, syrup, aluminum, cardboard.[[10]](#footnote-10) |
| [Supplier Concentration?](#Def_Supplier_Concentration" \o "How many suppliers are there for you to get the materials to produce your product? Is there competition among multiple suppliers e.g. commodities.) | Low | There are many suppliers that can offer the raw materials needed at similar prices. PepsiCo focuses on having a diverse portfolio of suppliers which lowers the threat of having costs increased from losing suppliers.[[11]](#footnote-11) |
| [Competition from substitute products for suppliers](#Def_Competition_substituteproducts" \o "Can different materials be used to produce the product?) | Medium | PepsiCo’s recipes are consistent and don’t have room for change. All of the same ingredients are needed to develop the products. However there is a possibility to use different materials for packaging. [[12]](#footnote-12) |
| [Is this industry an important customer for suppliers](#Def_IsIndustryImportantCustomer" \o "Is your industry the only industry that uses this specific supplier or are there other industries using the supplier?) | Low | In the United States alone, the soft drink industry held a total market share of 186.42 billion dollars in 2016.[[13]](#footnote-13) Therefore a large company such as PepsiCo is a highly important customer for its suppliers. Because PepsiCo purchases large amounts of the raw materials, it has higher power over the suppliers. |
| [Are the suppliers products differentiated/customized for this industry](#Def_SuppliersProducts_differentiated" \o "Do the products created by the supplier cater directly to your needs in the industry?) | Medium | The materials used from the suppliers are generic and used by many other industries. Therefore, suppliers aren’t relying solely on the success of soft drink companies.[[14]](#footnote-14) |
| [Do they earn high profit margins?](#Def_EarnHigh_ProfitMargins" \o "Do the suppliers sell for a high price but produce at a low cost?) | Low | PepsiCo’s suppliers earn 10.08% of net margins. This is high enough to keep the companies invested in PepsiCo but not too high were they control the power.[[15]](#footnote-15) |
| [Switching costs](#Def_Switching_costs" \o "Does it cost you any resources to switch suppliers?) | Low | PepsiCo has multiple suppliers and therefor can switch from suppliers with relatively low costs. The materials that they use are not differentiable, so it would be relatively easy to obtain more materials from other consumers.[[16]](#footnote-16) This gives PepsiCo freedom to enter into long contracts with multiple suppliers without fear of losing the materials needed to develop their products. |
| **[Buyer Power](#Def_Buyer_Power" \o "This force determines how much leverage the buyer (consumer) has in your industry in terms of quality, price, or other factors.)** |  |  |
| [Who are they?](#Def_Whoarethey" \o "List the buyers. Are they businesses or the end consumer? What types of businesses or consumers?) | Low | PepsiCo sells their products to foodservice customers, grocery stores, drug stores, convenience stores, membership stores, e-commerce retailers and authorized independent bottlers. Their top five retail customers represent approximately 32% their 2016 net revenue in North America.[[17]](#footnote-17) Normally large retailers would have power of their suppliers, but in this instance, PepsiCo remains in control. They do this by making themselves excellent business partners by stocking the products on the shelves with their own employees. Another reason is that customers demand PepsiCo products, so if a large retailer didn’t supply it, they would lose business to their rivals who do supply PepsiCo products. |
| [Buyer Concentration?](#Def_Buyer_Concentration" \o "Is there a huge market for your industry? Are there many consumers for your product?) | Low | According to a poll, 48% of Americans drink soda daily.[[18]](#footnote-18) Obviously, the soft drink industry is immense and has many buyers that regularly use the products. This is important for PepsiCo because it doesn’t have to rely on a few buyers to maintain profitability. |
| [Do the products of this industry represent a significant purchase for the buyers](#Def_ProductsRepresent_Significantpurcha" \o "Are the products offered in this industry a necessity for the buyers? Is it a luxury good or is it a necessity?) | Medium | Soft beverages, like soda, are not a necessity for buyers. Soda is often used for consumers enjoyment not because consumers require it. Evidence shows that when a tax is placed on soda that consumption decreases by a fifth. Evidently soft drinks are consumed when consumers have more disposable wealth.[[19]](#footnote-19) |
| [Are the products differentiated/customized?](#Def_Products_DifferentiatedorCustomized" \o "Are the products mass-produced or highly specialized catering to specific needs?) | Medium | Soft drinks are made in bulk with one product being the same as the next. However, there are some differences in products such as cherry Pepsi, Iced Teas, Sports Drinks, and others, which are used to provide a larger selection of products to consumers. PepsiCo is attempting to go even further and provide a new product Bubbly to further target the new healthy trends of the economy.[[20]](#footnote-20) |
| [Is there a credible threat of backward integration?](#Def_CredibleThreat_BackwardIntegration" \o "Can the buyers (especially businesses) create the product without going to your company?) | Low | PepsiCo goes to great lengths to keep their product secured. Their products are trade secrets and are legally protected.[[21]](#footnote-21) Therefore, a customer would be unable to recreate the flavor that Pepsi Cola offers. |
| [Do they earn high profit margins (for business buyers)?](#Def_EarnHighProfitMargins_BusinessBuyers" \o "Can buyers sell your products for a higher price than what you sell them for?) | Medium | Retailers of soft drink products make 10%-16% profit margins.[[22]](#footnote-22) This is enough to keep them invested in supplying the product but not too much as to where they would have the control over PepsiCo. |
| [Switching costs](#Def_BuyerPower_SwitchingCosts" \o "Do the buyers have any switching costs when thy buy from somebody else?) | High | Buyers don’t have switching costs for soft drink products. Competition creates low prices for consumers and purchase is based on preference rather than price. Therefore, a consumer could just as easily purchase a Coke or Dr. Pepper product instead of a Pepsi product.[[23]](#footnote-23) |
| **[Power of Substitutes](#Def_PowerofSubstitutes" \o "This force determines how likely it is for a consumer of a product to find a substitute product for a better price or better quality.)** |  |  |
| [What are they?](#Def_Substitutes_Whatarethey" \o "Who are the substitutes in your industry? Is your product replaceable for something else?) | High | Substitutes for soft drinks are coffee, hot tea, and alcohol. PepsiCo currently does not have any products in those areas of the beverage industry. All of these products are fairly popular and do take away the some of the profits from the main soft drink companies. To counter this many of the soft drink leaders attempt to acquire or create brands to meet a wider range of consumers’ needs.[[24]](#footnote-24) |
| [How close of a substitute are they?](#Def_HowClose_Substitute" \o "How close are the substitutes to what you are supplying in the industry?) | Medium | The substitutes in this industry have different purposes than those in the soft drink industry. Many early risers drink coffee to wake them up and keep them awake. Tea is used similarly as a casual drink. Alcoholic beverages are also used along with soda at parties but provides a completely different aspect. These days younger consumers are drinking more coffee and less soda. However, sports drinks are also becoming more popular so that a company like PepsiCo does not have to worry too much about this.[[25]](#footnote-25) |
| [Switching Costs?](#Def_Substitute_Switchingcosts" \o "Do customers have any risks associated with switching between your company to others?) | Medium | Prices are similar amongst these products. Time is a valuable cost for some people and coffee and hot tea takes longer to prepare, while alcohol is only viewed appropriate in a few social settings. However, people consume alcohol and coffee for deferent effects that soft drink fail to provide.[[26]](#footnote-26) |
| **[Power of Rivalry](#Def_Power_of_Rivalry" \o "This force determines how competitive the overall industry is and in determining whom you are competing against for market share.)** |  |  |
| [Industry concentration](#Def_Industry_concentration" \o "How competitive is the industry? How saturated is the industry you are working in? Are there many or few companies?) | High | There are only three major firms of recognition that control the market. These three firms own nearly 90% of the Market Share in the soft drink industry.[[27]](#footnote-27) Therefor it is hard for new firms to gain entrance and rivalry amongst these firms is high. The three large firms compete directly with each other in attempts to acquire their market share, if one company develops a new edge than this company could become the market leader in this highly profitable industry. |
| [Industry growth is slow/fast](#Def_Industry_growth_slowfast" \o "Is the industry on the rise or on the decline? Is the industry projected to have grow bigger or smaller?) | High | The soda industry has been on a gradual decline over the past few years. According to Forbes, in 2016 it saw a 0.8% decrease.[[28]](#footnote-28) While this may seem like an insignificant amount, this plays a large rule in a such a huge industry. What’s even more disturbing is that this number continues to drop off, while consumers become more health conscious. However, beverages overall will never fall too fall because many consumers view it as a necessity. |
| [Do the industry products have differentiation](#Def_IndustryProducts_differentiation" \o "Do the products have a difference between them or are they all very similar products?) | Medium | The products offered come from different recipes and have legal protection. However, soda in general can be grouped as similar products with few differences other than flavor. |
| [Do the incumbents have high stakes in the industry or are they diversified](#Def_incumbents_highStakes" \o "Do the companies currently in the industry have everything invested into that specific industry or do they operate in other industries as well?) | Low | PepsiCo has a rather diversified portfolio which includes several snack products other than soft drinks. Of PepsiCo’s 22 billion-dollar global brands, 8 of them are non-beverages.[[29]](#footnote-29) These highly profitable snack products insure that PepsiCo isn’t relying solely on the beverage industry. |
| [Asset specificity](#Def_Asset_specificity" \o "if an incumbent wanted to exit the industry, could they use their assets in a different way in another industry. If a particular asset can only be used in the focal industry then the assets are not transferable. ) | Medium | Filling Machinery, Mixing Equipment, Bottle Preparation Equipment, and a conveyor system are used in the production of soft drinks. Most of this equipment can be used in a similar industry such as food production. This would create lower exit barriers and provide unprofitable companies an incentive to leave the industry for more profitable markets.[[30]](#footnote-30) |
| [Demand stability](#Def_Demand_stability" \o "How consistent is the demand for the product?) | Medium | Soft drinks overall are always having a high demand. However, the most profitable part of PepsiCo, (soda products), has shown a slight decline in sales. While there are declines from year to year, it is never in large drops but a gradual decrease. Another factor that must be considered is that while soda sales decline, another product of PepsiCo, bottled water, has had an increase in sales.[[31]](#footnote-31) |
| [Exit barriers](#Def_Rivalry_Exit_barriers" \o "Is it difficult for any company to leave the industry they are currently in?) | Medium | In the soft drink industry, it would be easy for small companies to exit since they would just have to sell off their existing assets. This is a positive for Pepsi and the larger companies because more companies would have an easy time of leaving the market which would lead to higher market share for PepsiCo. However, it would be quite difficult for large firm to leave the industry, because they would lose money from advertising expenses at from breaking long-term contracts already established. |

PepsiCo is one of the leaders in the soft drink industry with 30% market share. After analyzing the soft drink industry using the Porter’s Five Forces, we have identified the following components that offer high influence for PepsiCo.

Buyer Power

* Switching Costs

Substitutes

* Substitute Factors

Power of Rivalry

* Industry Concentration
* Industry Growth

Porter’s Fiver Forces Analysis shows us that Rivalry and Substitutes are the most important factors that PepsiCo should focus on. There are only a few large firms in the industry which results in intensive rivalry. The rivalry leads to increased spending on advertising and new products. PepsiCo will lead need to continue to advertise to the younger generation in order to overcome Coca-Cola, the current market leader. Industry growth is also a concern. Consumers are becoming more health observant and are purchasing less soda in favor of more healthy options. In order to counter this, PepsiCo has created a portfolio of healthier alternatives.

Substitutes pose another issue for PepsiCo. Coffee, Hot Tea, and alcoholic beverages provide characteristics with which PepsiCo’s products have yet to meet. For PepsiCo to combat the loss in sales to substitutes, it could include those substitutes into their portfolio. One strategy PepsiCo could adopt, is to follow Coca-Cola’s move and experiment with alcoholic beverages in foreign countries.[[32]](#footnote-32) If PepsiCo was able to successfully complete this move, they would diversify their portfolio and minimize losses from substitutes. It is also worth noting that buyers have little to no switching costs between soft drink products. One way to combat this would be to advertise what consumers are losing when they switch from Pepsi to another product, such as taste or an experience.

1. https://www.beverage-digest.com/factbook [↑](#footnote-ref-1)
2. https://www.statista.com/statistics/286547/pepsico-advertising-spending-worldwide/ [↑](#footnote-ref-2)
3. https://www.forbes.com/sites/greatspeculations/2016/03/16/how-pepsico-is-improving-its-brand-loyalty/#fa91c3c15559 [↑](#footnote-ref-3)
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27. https://www.forbes.com/sites/chuckcarnevale/2013/10/25/dr-pepper-snapple-dont-overlook-this-beverage-contender [↑](#footnote-ref-27)
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