Fahrenheit212

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EVERYDAY.

Preliminary Strategic
Recommendation

PEPSICO

Innovation Exercise

Ben Biddle

Executive Summary

To realize North American incremental sales growth of $100 million in the functional beverages sector from a new product introduction, PepsiCo must redefine the function in functional beverages. Too much focus on health benefits positions functional beverages in close competition with vitamin supplements and medicines. What people want from their food and drink is good taste and convenience, to get back to enjoying the lifestyle they want to live. There are three vectors of innovation PepsiCo can exploit:

- Consumer distrust of health claims on functional beverages can be overcome by repositioning the product and focusing on observable benefits.
- Functional beverages are not relied on as extensively for weight loss or weight management as functional foods, an opportunity to shift market share toward the convenience of a healthy drink on the go.
- Congruence with consumer behavior patterns can lead to an incremental uptick in the frequency of consumption, translating into a dramatic increase in functional beverage sales.

PepsiCo has in its research and development portfolio technology to capitalize on this opportunity with a healthy, filling, drinkable snack for daily consumption before or between meals.

Notes on this report:

The intent of this strategic recommendation is to grow PepsiCo annual revenues in the functional beverages market by $100 million in 3 years time. Functional beverages are defined as beverages that are enhanced with added ingredients to provide specific health benefits.

Unless otherwise noted, the underlying research comes from Mintel's November 2006 report Functional Food and Beverages *and the more recent May 2010* Functional Beverages *and August 2009* Functional Foods*.*

Functional food and beverages are both complementary and competitive with one another so the discussion herein will sometimes refer to the two jointly. At some times "food" is used in a general sense to refer to both food and beverages. At other times, explicit reference will be made to drinks, beverages, and specifically functional beverages to highlight points of differentiation and competitive advantages.

*Redefine the **function** in functional beverages. Give consumers the control of their diet to get back to **living** their **lives**.*

Competitive Threats

Despite functional beverages sales growth of 25% from 2004-2008, the sector declined in 2009 overall by 2% to $9 billion. The drop in sales masks continued strength in some segments such as energy drinks, which grew 6.3% to just over $1 billion in 2009.

Unfortunately for PepsiCo, the current leader in functional juices and juice drinks, that segment has led declines with a 3.2% drop or $174 million. In 2009, sales of the Tropicana brand suffered double digit percentage declines attributable to a package redesign early in the year.

While at the end of 2005 PepsiCo enjoyed a greater than 10% segment share lead over #2 Coca-Cola, in 2009 that lead was compressed to just 1%. Competing brands are not the only threat either. Juices are a near commodity product and as such, particularly susceptible to competition from private labels.

With a deteriorating market position in functional beverages, PepsiCo will either create the next successful functional beverage segment or cede still more ground to competitors and new entrants. The way forward is redefining the function in functional beverages to focus on giving consumers the control over their diet to live the lifestyles they desire.

Positioning

In the past, when people wanted to treat or prevent a health condition, they were accustomed to taking medicine. Today, people are becoming more proactive about their health and taking a holistic view that includes diet. The body of information on the connection between diet and health is growing. Simply avoiding foods considered unhealthy has expanded to actively seeking out others considered healthy.

This has been a boon for functional food and beverages, with producers touting an increasing array of health benefits on food labels. Marketers have effectively positioned these products somewhere between food and

*There is still a part for functional beverages to play in the **whole foods** movement.*

medicine,[1] but the unintended consequence has been a recent slowdown in sales as the popular sector comes under increasing scrutiny.

The science of diet and nutrition is an uncertain one. Clinical studies controlling for the many variables are hard (and expensive) to design and execute. The benefits of the Mediterranean diet and green tea are largely anecdotal. The only real advantage functional beverages offer against the better substantiated claims of medicines is availability, but that has not been compelling enough for consumers to pay the perceived price premium over regular beverages, especially during an economic downturn.

On the other side of the competitive spectrum, pundits like Marion Nestle and Michael Pollan are promoting the merits of whole foods over processed ones. Good nutrition depends on a complex interplay of vitamins and minerals as demonstrated in the July 2009 article in the *Harvard Health Letter*, "Nutrition's Dynamic Duos," and the approach being advocated is a more natural diet.

Vitamin supplements are even being criticized as suboptimal alternatives to a well balanced diet that includes several servings of fresh fruits and vegetables. Functional beverages marketers can use this to their advantage by directing consumer attention to natural ingredients and benefits not readily available from a typical diet. There is still a part for functional beverages to play in the whole foods movement.

Purchasing Decisions

__Taste__ and __convenience__ remain two of the most important factors in the consumer's purchasing decision.

What people really want is to stop worrying so much about food and get back to enjoying life. Taste and convenience remain two of the most important factors in food purchasing decisions. Eating and drinking is about the pleasure of the experience itself and getting the fuel to enjoy life's many other pleasures. "Tasty and convenient" in the US, however, often means high fat, high calorie.

People know they should be eating better. In 2009, 38% of consumers reported that they simply do not have enough time to prepare and eat healthy meals, 4 percentage points more than in 2006. In a 2006

[1] Marketers have been careful to avoid claims that would lead to the reclassification of a product as a supplement or drug.

Associated Press poll, 44% of US respondents admitted to buying foods that are bad for them despite checking labels frequently.

Functional foods and beverages help people feel better about their other dietary habits. In 2006, it was the number one reason cited by consumers for why they purchase both functional foods and functional beverages. Indeed, 49% of consumers agree that one does not need to use functional food and beverage products if one eats a healthy diet.

Low Adoption Rates

*The cacophony of claims has left consumers feeling **skeptical** and **confused**.*

More people are not consuming functional food and beverages because they do not know which claims to trust. Since 2003, the Food and Drug Administration (FDA) has simplified the process for reviewing diet-disease claims to empower consumer with up-to-date scientific information. Within three years, the number of qualified health claims jumped by two dozen. Overtime health claims on labeling have proliferated. The resulting cacophony has left consumers skeptical and confused.

Over the same period since 2003, the US consumer has grown distrustful of large companies. The accounting scandals of 2001-2002 and the financial crisis of 2008-2009, combined with worry about climate change has spurred a new era of social responsibility, in which consumers expect managers to be more considerate of society and environment.

Looking for alternatives that are better for them and for the environment, consumers have taken organics from subculture to mainstream in a matter of years. The functional food and beverages sector is shifting in response. In 2008, 23% of new product introductions were “natural” products. PepsiCo can ride this wave with other producers, but some differentiating innovation must be included to achieve exceptional results.

The Role of Consumer Behavior

Ironically, self-defeating consumer behavior is a significant cause for unrealized benefits from functional food and beverages. Many health claims are qualified “as part of a healthy diet.” Others require an extended period of regular consumption for any demonstrable benefits.

Frequency is also a significant issue. Most consumers report using functional food and beverages fewer than 10 times in the past month, far less than the frequency needed to substantiate many health claims. Consumers are stuck in a catch-22, unwilling to spend more on functional food and beverages that do not seem to work because they are not using functional food and beverages often enough.

Focus on ***observable*** *benefits.*

It should be no surprise, then, that the segments showing the most significant growth and resilience in a down economy have been mood enhancers. Products considered mood enhancers claim some psychological or cognitive benefit that is almost immediately observable and verifiable. Examples include energy drinks, enhanced waters and some sports drinks.

Winning over skeptics and converting nonconsumers is easier with observable benefits. Try-and-buy promotions are more straight forward and less expensive than the clinical studies and partnerships with outside foundations employed by marketers in other segments. Focusing on observable benefits has the added perk of reducing the regulatory risk exposure as well.

Weight Loss Disconnect

More than almost any other health issue, Americans are worried about their weight. In 2008-2009, 52% of consumers reported “watching” their diet, and the desire to lose weight was the most common reason given for doing so (58%).

In 1999, the Center for Disease Control (CDC) declared obesity an epidemic. According to the American Dietetic Association and the Institute of Medicine, 30 million people live with chronic nutrition related conditions, including obesity, at an annual cost of $300 billion a year. A surprising $^{2}/_{3}$ of American are considered overweight.

Weight loss is big business. MarketData Enterprises *The US Weight Loss and Diet Control Market* (9^{th} Edition) estimates the weight loss market at $58.6 billion. Yet functional foods seem to be playing a bigger role than functional beverages in the consumer’s struggle to maintain a healthy weight.

*There is an opportunity to shift market share to functional beverages in **weight loss** and **weight management.***

While a comparable proportion of consumers report using functional foods (48%) and functional beverages (43%) to make up for less healthy eating habits, only 31% of consumers reported using functional beverages for actual weight loss and weight management. This compares to 44% in the functional foods segment.

These statistics do not account for people buying low calorie diet drinks, such as Diet Pepsi, but they are still very revealing. One of the likely explanations for this disconnect is that the feeling of satiation is harder to achieve with beverages that are low in protein, unsaturated fat and fiber (all of which have been shown to contribute to satiation).

One advantage functional drinks have over functional foods is convenience. Consumers have relied increasingly on ready-to-drink (RTD) juices for an additional source of fruit and vegetable servings in their diet. Unlike a 12 oz. bottle, the two largest segments of functional foods, dairy products (including yogurts) and cereals, frequently require a utensil and are hard to eat on the go.

*Functional beverages are a **convenient** option on the go.*

Functional beverages, on the other hand, can be consumed even while driving and do not require their own accompanying drink, as some might feel snack bars do. Functional beverages can also circumvent the need for refrigeration. Offering people a tasty, convenient alternative to functional foods to help maintain a healthy weight will shift market share toward functional beverages.

Behavioral Congruence

Converting nonconsumers by winning over skeptics and shifting the weight loss and weight management market share will both help grow sales of functional beverage. Increasing the frequency of consumption, however, may offer still greater gains and could be more easily attained.

Most consumers report purchasing fewer than 20 servings of functional foods and beverages in the past 3 months. As noted earlier, they also consumed functional beverages fewer than 10 times in the past month. PepsiCo needs to find a product that fits well with the behavior patterns of its existing consumer base to increase the frequency of consumption.

*Finding the right **behavioral fit** will increase the frequency of consumption.*

One of the inherent limitations of functional beverages such as sports drinks is that they only seem to go with particular activities, athletics in this case. Conversely, the genius of something like enhanced water is that it goes with almost any occasion, except perhaps an economic downturn when tap water becomes much more tempting.

If a new functional beverage from PepsiCo is going to help consumers live the lifestyle they want, then it should be associated with frequent activities in the consumer's life. What better activity than meals for addressing the weight loss and weight management market.

Candidate Technology

After reviewing PepsiCo's technology pipeline, one technology in particular stands out as a good candidate for PepsiCo's next $100 million product. Adding an ingredient to low calorie beverages that leaves consumers feeling temporarily full will open a new competitive front in the large weight loss market. A drinkable snack to stave off cravings between meals will encourage consumers to drink up not just a couple times a week but a couple times a day.

Weight loss is a large market with an attractive consumer profile. Women and the aging Baby Boom generation are a large portion of the weight loss consumer population. Both consumer groups have characteristics that marketers can effectively target with a satiating drink.

Women are more concerned than men with weight management. Women responded that they consume functional food for weight loss more often than men by 11 percentage points. Working moms do not always have the time to eat healthy or go to the gym so they will value a product that gives them more control over what and when they eat.

Working moms are particularly well represented in the 25-34 age range. Consumers 25-34 are the most likely to have purchased a functional food or beverage in the past 3 months. They consume functional beverages more often than any other age group (15% reporting more than 30 times in a 3 month period).

Older consumers, specifically the fast growing 60+ age group, have the highest instance of obesity in the US. As people age, they tend to live a more sedentary life, requiring fewer calories, but for the young at heart, a drinkable snack is good for things like retirement travel and keeping up with grandkids. In fact, in the future, Baby Boomers are likely to try more functional foods and beverages to maintain their health and independence into old age.

The vitamin combination for memory and recall is admittedly an appealing possibility for marketing to Baby Boomers, but it seems to be a harder claim for the consumer to verify when compared to satiation. Any additional demand from younger consumers is also questionable given the popularity of energy drinks as an alternative. There are also already a number of competing products out there, for example Neuro Sonic.

Still, there are plenty of competing products for a satiating drink as well. All the low calorie drinks containing artificial sweeteners are one source of competition, but they cannot offer a full feeling on their own. The few drinks that can, tend also to be high in calories, as in the case of meal replacement shakes.

The satiating ingredient could actually co-opt the popularity of existing low calorie drinks. The ingredient that reduces caloric value by 25% alone would be too hard to differentiate and might suffer from the stigma of a taste trade off associated with artificial sweeteners. Consumers value options, and the satiating ingredient could be used to develop a variety flavors. Imagine a filling coconut water snack.

Risks and Further Investigation

As noted, right now natural products are very popular. As part of their new found health consciousness and environmental concern, consumers are paying more attention to how their food s are processed. Marketers should therefore downplay processing, and focus on natural ingredients.

More analysis is needed to decide the appropriate drink format for the satiating ingredient, e.g. juice, water, etc. Getting a more detailed understanding of the target consumer will help refine the product and go-to-market strategy.