Globalization of the Soft Drink Industry

The beverage industry is a bellwether in the food industry, where globalization has affected structure. Soft drink companies produce for domestic and foreign markets, license their products, and invest in plants in other countries through foreign direct investments (FDI). Names such as Coca-Cola and Pepsi are recognized worldwide, and foreign brands are being consumed in record amounts in the U.S. Consequently, national brand association can be confusing or even meaningless.

For example, the Dannon brand is produced in the U.S., while Poland Springs water is owned by Nestle (based in Switzerland). Moreover, national ownership of brands may change overnight, slanting consumers' perceptions of national brands. The Schweppes brand, for example, is owned by Coca-Cola in 155 countries.

U.S. soft drink companies trade under some of the most widely recognized names around the globe. About half of Coca-Cola and Pepsi sales are abroad, and PepsiCo ranks sixth among the largest global food and beverage companies, with sales of $27 billion. Coca-Cola, with sales of nearly $20 billion, is eighth. Coca-Cola controls about a quarter of the world's $393-billion dollar global soft drink industry (defined by Euromonitor as carbonated beverages, fruit/vegetable juices, and bottled water), Pepsi controls about 11 percent, Nestle 4 percent, and Philip Morris 3 percent.

Among global soft drink sales, carbonated beverages are the largest market segment, with $193 billion in sales. Fruit and vegetable drinks and bottled water shared second place with roughly $69 billion each in sales in 2001. The overall trend is one of increasing the variety of soft drinks produced by multinationals. Improved infrastructure and packaging expand market potential.

Three major shifts have occurred in the business environment of these manufacturers since the end of the 1980s:

- refocusing the business view from national to international;
- expanding firms' activities across business lines; and
- growing competition in the global soft drink industry.

Beverage companies' international ventures clearly show the role U.S. firms play in generating economic growth that is based on a global rather than a national view of the market, and tied to specific companies.

Beyond the trends in composition and level of FDI, two questions come to mind from the U.S. standpoint:

- What is the tradeoff between trade and sales resulting from U.S. FDI?
- What is the effect of trade liberalization on FDI?

U.S. Firms Search for Global Market Gains

Competition for market share in the U.S. is keen, and U.S. per capita consumption of soft drinks is already the highest in the world, at 161 liters. So, U.S. beverage companies have expanded abroad, particularly to the high-income countries of Western Europe and more recently to middle-income countries where populations and opportunities for increasing incomes are expanding.

The U.S., Japan, Mexico, Germany, China, and Brazil are the largest soft drink markets, and per capita consumption has increased by double digits since 1997. While total U.S. consumption grew by 6 percent, consumption in most other countries increased faster. The dollar volume, however, declined in several major countries (including Brazil) as the dollar strengthened relative to their currencies.

Beverages lend themselves to FDI, particularly those that are easily replicated through a standardized process and set of ingredients. Because of the high cost of shipping and handling liquids, beverage companies find it less costly to invest in foreign affiliates than to export. U.S. companies directed most of their FDI to Mexico, the United Kingdom, France, Canada, and Brazil. The bulk of the $15 billion of U.S. beverage FDI is in soft drinks.

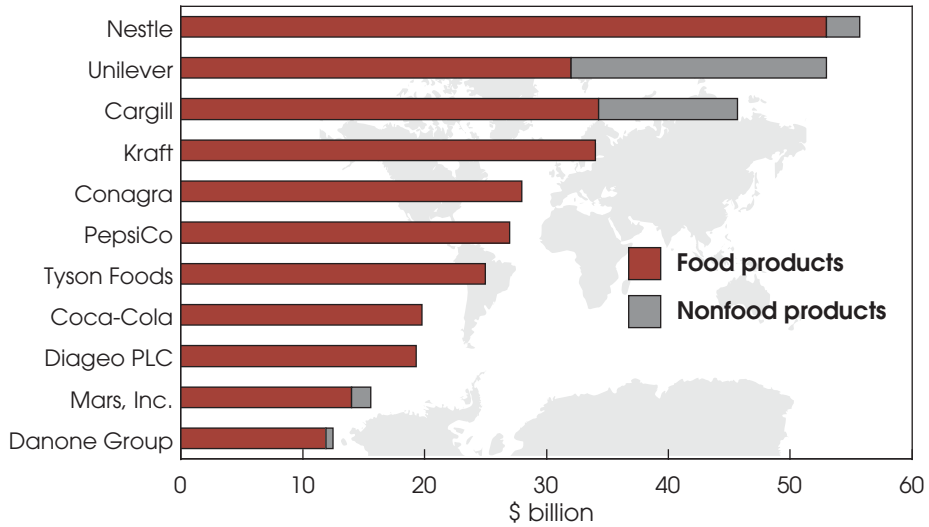
Licensing also plays a major role in the global beverage industry, where name recognition is vital. Licensing existing plants and distribution systems to handle products is often more profitable than building plants and establishing distribution systems.

A Case of Foreign Investment

Coca-Cola's relationship with Coca-Cola Amatil is an illustration of the complexity of foreign investment in the soft drink industry. In 1977, Amatil (then part of British Tobacco Company) purchased the Coca-Cola bottling companies in Vienna and Graz, Austria, and in 1989, purchased bottling companies in New Zealand and Fiji. By 1989, the Coca-Cola parent company became the majority stockholder of Amatil, after it was spun off from the original tobacco business.

Amatil then became Coca-Cola Amatil, which then expanded to New Guinea, Central and Eastern Europe, and the Philippines. The European segment of Coca-Cola became Coca-Cola Beverages in the same year. Much of this was achieved through licensing of the Coca-Cola brand. Foreign affiliates of the U.S. soft drink sector generate billions of dollars in sales compared with U.S. exports, which are in the millions.

Leading Food and Beverage Companies Worldwide, 2001



Sources: *Global Supermarket*, Department of Foreign Affairs and Trade, Austrade, Australia; selected company income statements.

Economic Research Service, USDA

A typical licensing agreement allows a beverage company to produce and market the branded beverage of another company by paying a royalty fee to that company. In exchange, the licensing company insists that consistent quality be maintained. The licenser is selling its knowledge of producing the specific beverage and the right to use that trademark (and the name recognition built into that trademark) in exchange for the royalty payment. U.S. beverage companies currently have licensing agreements with companies in Canada, Japan, and China.

Market Segmentation Is Less Clear

Beverage companies have also consolidated to include multiple beverage categories—soft drinks, beer, bottled water, flavored drinks, wine, and distilled liquors—so that it is now difficult to segment the trillion-dollar global beverage industry. Companies that were solely beverage manufacturers have expanded far beyond their original product lines.

Segment crossing has occurred throughout the industry as companies seek ways to cut marketing and transportation expenses, handle increased competition, and utilize existing capacity more efficiently. As beverage companies recognized the increased market power of retailers, they began offering a bundle of products to large-scale retailers and food service corporations as one way of accomplishing those objectives.

The two leading soft drink companies—Coca-Cola and PepsiCo—viewed the market in different ways, and have chosen different paths for expansion.

- Coca-Cola stayed in soft drinks, fruit juice, sports drinks, and bottled water, while PepsiCo ventured beyond beverages into snack foods and breakfast cereals.
- PepsiCo invested in fast-food restaurants that have since spun off. Quaker Oats (with its subsidiary Gatorade) is part of the PepsiCo domain. PepsiCo also expanded into other marketing channels—particularly restaurants.
- Both PepsiCo and Coca-Cola relied on licensing and special bottling agreements to establish markets abroad. PepsiCo, for instance, bottles for Dole juice, Starbucks coffee drinks, and canned Lipton iced tea.

Investments are often tied to fast-food franchises, global hotel chains, entertainment venues, and other institutional channels. Licensing and other exclusive use of product brands are often combined with FDI as a means of reaching an even broader local consumer base. PepsiCo was perhaps the farthest reaching in this approach when it also owned fast-food enterprises such as Pizza Hut, Kentucky Fried Chicken, and Taco Bell, where its product was sold exclusively. FritoLay, the snack food division of PepsiCo and the world's fourth-largest snack food provider, has global sales rivaling PepsiCo's soft drink division.

Competition Keen in the Soft Drink Market

The soft drink industry found new competition as it expanded. The bottled-water phenomenon marked a new opportunity in the beverage industry, where local companies supplied local markets and had little brand recognition beyond their respective areas. As health concerns captured the interest of the American public and U.S.

consumers developed brand recognition for European bottled spring water brands such as Perrier and San Pellegrino, a booming market for water arose.

Japanese companies consolidated bottled-water companies during the 1980s, keeping the already recognized regional brand names. Coca-Cola and PepsiCo developed brands of their own, which could flow through their already established marketing and distribution systems, to meet this new consumer demand. Competition came from several segments of the food industry–Nestle (Switzerland), Danone (France), and Suntory (Japan) invested heavily in major U.S. bottled-water companies.

The call for health-oriented drinks by U.S. consumers led PepsiCo to purchase Tropicana orange juice, and Coca-Cola to purchase Minute Maid. These purchases put the soft drink companies into competition with yet another group—fruit juice processors.

Does FDI Complement Exports?

A comparison of U.S. FDI sales with U.S. exports illustrates the magnitude of FDI beverage sales. Sales from U.S. FDI in the global soft drink industry were well above $30 billion in 1999 in a global market of $393 billion. U.S. soft drink exports totaled $232 million in 2001, compared with $105 million in 1990.

FDI can potentially expand U.S. syrup and flavoring exports since these ingredients are necessary inputs for soft drink production. Increased foreign production of soft drinks by U.S. affiliates has caused a boom in exports of syrups and flavorings. Syrup and flavoring exports doubled to $981 million from 1990 to 2001, far exceeding soft drink exports.

Beverage production location also impacts international sugar and grain markets, since soft drink producers utilize large quantities of sugar, corn sweeteners, and fruit/vegetable juices. But soft drinks that are not agriculturally based at all (such as Tang) are important branded products in the food sector.

The experiences of Coca-Cola and PepsiCo demonstrate that a firm that starts as a soft drink manufacturer does not necessarily expand by producing more soft drinks, but can expand into varying product lines.

Other segments of the beverage industry offer myriad examples of diversification. Allied Domecq, a large British-based liquor multinational, owns companies as diverse as Dunkin' Donuts and Baskin and Robbins ice cream stores. Allied Domecq and Diageo (another large British-based liquor multinational) have also purchased wineries. Integration of economies and industries has affected firms' decisions on how to deal with larger markets and keener competition. AO

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Season's Greetings

From the staff of *Agricultural Outlook*

This month marks the final issue of *Agricultural Outlook*.

Beginning in February, USDA's Economic Research will begin publishing a new magazine. It will cover the broad range of issues addressed by the agency's information and analysis—production agriculture, trade, food safety and nutrition, rural development, and the environment. Each issue will provide a sampling of ERS reports and ongoing research.

For details, turn to page 46.