ADVISEN Insight for Insurance Professionals

John Molka
Senior Industry Analyst and Editor
212-897-4825
jmolka@advisen.com

BEVERAGES INDUSTRY RISK MANAGEMENT PERSPECTIVES

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Industry Overview

The beverages industry, with almost $250 billion in annual U.S. revenue,[1] provides all forms of liquid refreshment, from soft drinks to whiskey. Nonalcoholic beverages include carbonated soft drinks, bottled water, juices, sports drinks, ready-to-drink teas, and a cornucopia of newly created alternative beverages. Alcoholic beverage producers span from beer brewers to wineries and distilled spirits makers. This industry does not include milk, and whole tea and coffee products (including powdered ice tea and instant coffee), which are part of the food products industry. But ready-to-drink teas and coffees are part of the beverages industry.

It is a mature and saturated industry, but profit margins remain high due to its concentrated structure, particularly for the highly regulated alcoholic beverage side of the industry. Barriers to entry keep the industry concentrated, which includes the high cost of advertising, manufacturing facilities, and distribution costs. Economies of scale from the latter two give large companies competitive advantages. The cost of legal regulations for makers of alcoholic beverages is an additional barrier for small startups to overcome. Labor, packaging, transportation, capital expenditures, and advertising are the largest cost areas for companies in this industry.

The mature nature of the industry limits price flexibility. This makes customer loyalty paramount, which is why the giants are among the leading advertisers globally. However, distilled spirit players are limited in their ability to advertise on television, but they do advertise to great lengths in magazines and on billboards, and have started advertising on cable TV channels late at night.

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[1] *Beverage Digest* and *Adams Handbook Advance 2005*.

Nonalcoholic Beverages

Three giants dominate the nonalcoholic beverage segment: Coca-Cola, PepsiCo, and Cadbury Schweppes. These three companies are responsible for 89% of carbonated soft drink sales in the U.S., the largest category within this segment.[2] Despite this concentration, many small niche players exist, and the segment is large, employing over 169,000 people in the U.S.[3] U.S. sales for the top-five categories of this segment totaled $92.3 billion in 2004, consisting of: carbonated soft drinks ($65.9 billion), bottled water ($11.4 billion), juices ($6.4 billion), sports drinks ($5.4 billion), and ready-to-drink teas ($3.2 billion).[4]

The manufacturing and distribution process involves some combination of brand owner and bottler interaction. Brand owners typically make concentrates, then either manufacture and sell products themselves, or appoint bottlers to sell, distribute, and sometimes manufacture the products under licenses. For example, Coca-Cola and PepsiCo own beverage trademarks and secret formulas for concentrates, and sell their concentrates to licensed bottlers (where Coca-Cola and PepsiCo own as much as 35% to 40% of these bottlers). They develop new products and packaging for use by bottlers, and develop national marketing and advertising programs to support brands. They also coordinate selling efforts to national fountain, supermarket, and mass merchandising accounts.[5]

Bottlers are responsible for manufacturing, selling, and distributing products for their exclusive territory, although in some cases are involved in only selling and distributing products. For Coca-Cola and PepsiCo, bottlers buy their concentrates, combine them with sweeteners and carbonated water, package the beverages in bottles and cans, and then sell the final products to wholesalers and retailers. Bottlers handle fountain accounts as well by combining the concentrate with sweeteners, creating syrups, and distributing the syrups. But these fountain accounts are usually license agreements between brand owners and restaurants, stadiums, arenas, schools, and other facilities.[6]

The big-three beverage producers in this segment have restructured to improve profitability. They reduced supply chain costs by using B2B marketplaces for carrying out procurement activities, and have streamlined transactions with suppliers, buyers, and distributors.[7] Pepsi Bottling Group (43% owned by PepsiCo) acquired the share of Pepsi Gemex that PepsiCo did not own (65%) for $900 million in November 2002, which helped to sure up price flexibility by consolidating distribution and bottling networks in Mexico. The big-three have also lowered operating costs and enhanced margins by eliminating less profitable brands, and acquiring brands in growing areas. PepsiCo acquired Quaker Oats for $13.5 billion in August 2001, which included Gatorade, the leading sports drink brand. In October 2000, Cadbury Schweppes acquired Snapple Beverage Group for $1.5 billion.

Carbonated Soft Drinks

One of the largest parts of the beverages industry, and the forefather to all modern nonalcoholic beverages, is carbonated soft drinks. Soft drinks accounted for $65.9 billion, or almost 27% of beverage consumption and 71% of nonalcoholic beverage consumption in the U.S. in 2004. This translates to 52.3 gallons consumed per-capita in

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[2] *Beverage Digest*.
[3] Bureau of Labor Statistics.
[4] *Beverage Digest*.
[5] "Food & Nonalcoholic Beverages," Standard & Poor's Industry Surveys, June 9, 2005.
[6] Ibid.
[7] Ibid.

the U.S. and one-in-four drinks consumed by Americans.[8] This is second only to beer consumption, which accounted for $82.2 billion in revenue in 2004, just below 6.4 billion gallons, or about 33% of beverage industry revenue.[9] The U.S. market includes 450 different brands of soft drinks and 400 bottlers. Modern bottling plants can produce 2,000 cans of soft drinks per minute on each operating line. Nearly 77% of soft drinks are packaged, whiled the remaining 23% are served through fountains.[10]

Manufacturing of soft drinks began in the 1830s, as pharmacists created concoctions by combining carbonated mineral water with a multitude of ingredients from birch bark to dandelions in an attempt to cure ailments. Although no cures came of these experiments, popular flavors were born, including ginger ale, root beer, sarsaparilla, lemon, and strawberry.[11]

Mixing sodas at neighborhood fountain shops and corner drugstores grew in popularity, but a demand for home use grew as well. The problem was keeping the corks from popping due to carbonation. In 1892, the crown cap was invented to prevent carbon dioxide from escaping, and it revolutionized the beverage industry. Many pharmacists, in search of fortune, abandoned their trade to become full-time bottlers. Most drugstores began selling bottled soft drinks.[12]

But it wasn't until the 1920s and the invention of the first six-packs when the trend took hold. Also, vending machines and fountain dispensers proliferated its consumption, also beginning in the 1920s. The automobile heralded a new age for soft drinks, as roadside stands and service stations became major outlets, which started expanding in the 1940s and 1950s. This was also a time of the creation of new innovative brands, many still around today.[13]

Soft drinks are still king of the beverage road, but are no longer growing at high levels due to their saturation of the market to the point of ubiquity. Many alternative beverages are considered growth areas, such as enhanced waters and teas, originally flavored fruit juices, and energy drinks. However, the big-three producers are not only attempting to enter these new areas, but also inventing new soft drink brands with some success, such as the ever-changing taste of Sprite Remix (Coca-Cola), the successfully launched Sierra Mist (PepsiCo), and Mixed Berry 7Up Plus fortified with calcium and vitamin C.

Alcoholic Beverages

The three areas within the alcoholic beverages segment are beer, wine, and distilled spirits. It is a concentrated and profitable segment. Many brands have consolidated under a handful of global companies. Manufacturing and distributing economies of scale, the steep cost of advertising, a decline in U.S. alcohol consumption, and rising legal and regulatory burdens around the world have been driving this consolidation. This consolidation takes advantage of barriers to entry, creating cartel-like pricing with high profit margins.[14] The only exception to the highly concentrated nature is the wine arena. It is concentrated, but to a lesser degree. The wine segment has a few

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[8] *Beverage Digest.*
[9] *Adams Handbook Advance 2005.*
[10] The American Beverage Association.
[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.

large U.S. producers in the lower end of the market, but there are also many small wineries in the U.S., combined with intense global competition in the middle to higher end of the market.

Large companies gain advantages in distribution as well, because they get shelf space and beer taps, and can offer promotional deals to bars. Large beer companies distribute their products themselves, but wine and distilled spirits companies need to deal with wholesalers. But wholesalers favor large companies that give them favorable terms. Microbreweries and small wineries have regional success, but it is often difficult for them to maintain profitability and go national, although some have had success nationally.

In 2004, the U.S. alcoholic beverages segment had $154.6 billion in revenue (includes excise taxes), up 6.3%, consisting of: beer at $82.2 billion, spirits at $49.4 billion, and wine at $23.0 billion. U.S. consumption was slightly up in 2004, at 7.4 billion gallons, with increases in consumption of all three segments, but revenue was up much more due to the continued trading up to premium products. The breakdown in consumption for 2004 was: beer up 1.5% to 6.4 billion gallons ($82.2 billion), spirits up 4% to 394 million gallons ($49.4 billion), and wine up 4% to 635 million gallons ($23.0 billion).[15]

Beer The big-three U.S. brewers accounted for 79.6% of volume sold in the U.S. in 2004. The big-three are: Anheuser-Busch (AB) at 49.4% U.S. market share, up 0.4% in 2004 to 103.0 million barrels; Miller Brewing Company (part of SABMiller) at 18.5% market share, down 0.4% to 37.4 million barrels, and Adolph Coors Co. at 10.7% market share, down 0.8% to 22.3 million barrels (1 barrel = 31 gallons).[16] SABMiller was formed in July 2002 when U.K.-based South African Breweries acquired Miller Brewing from Philip Morris (now Altria Group) for $5.4 billion. Altria Group owns 36% owned of the newly formed SABMiller. In January 2005, Adolph Coors Co. merged with Molson Inc. to form Molson Coors Brewing Co., the No. 5 global brewer by volume.

Beer is almost as old as civilization. It's easy to make and made mostly of malted barley flavored with hops and other ingredients. Bitters are brewed with more hops and light malt. Lagers are usually light colored beer that matures longer than other types and bottom-fermented. Pilsners are heavily hopped lagers. Ales are usually heavier and darker than lagers, and are top-fermented. Some ales are made from malted wheat, called wheat ales. Stouts and porters are dark ales produced from brewing roasted malts. Lagers are preferred in the U.S., with light beer consumption growing since the 1980s, but other categories are growing in popularity. U.S. consumers are becoming fickle and tired of mass-produced lagers, and are becoming fonder of imported and craft (microbrew) beers of all varieties.[17]

The big-three U.S. brewers are vertically integrated, but AB is the most vertically integrated.[18] It purchases raw materials from both internal and external sources. Busch Agricultural Resources is a subsidiary that conducts rice drying and milling, engages in research, operates grain elevators in numerous locations, and conducts farming activities for certain grains. Its Metal Container Corporation subsidiary manufacturers cans. The Precision Printing subsidiary produces folding cartons, metalized labels, and paper labels. Finally, Anheuser-Busch Recycling Corporation recycles aluminum cans and glass bottles.

Spirits In 2003, the U.S. spirits market sold 165.7 million cases (1 case = 9 liters). Like beer, it is also a concentrated market, but more reliant on international brands. The top-five companies in 2004 were responsible for 55% of depletion (volume) in the U.S., and the top-10 accounted for 77%. Diageo, the No. 1 seller of spirits in

[15] *Adams Handbook Advance 2005*.
[16] *Beer Marketer's Insights*.
[17] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.
[18] Ibid.

the U.S., had 22% of the market, or 37 million cases. Bacardi became No. 2 with its acquisition of Grey Goose in June 2004 from Sidney Frank Importing Co. for $2 billion. Bacardi had 90% market share, or 15 million cases. Allied Domecq plc was No. 3, accounting for 8% of the U.S. market, or 12 million cases. However, this list will probably change by the end of 2005, as Pernod Ricard S.A. and Fortune Brands have agreed to acquire Allied Domecq plc for $14 billion. The U.S. beer market is more dependent on the big-three brewers than the U.S. spirits market is on its top-three, but the spirits market is more international. Therefore, on a global basis, spirits are as equally concentrated, and becoming more so with further consolidation.[19]

Spirits producers are not quite as vertically integrated as large brewers. They purchase raw materials (usually grains) via contractual arrangements and open market purchases. Grains are mashed at company distilleries, and then finished products are aged for varying time periods. Distilled products are distributed through wholesalers or state-level alcoholic beverage control agencies.

Three basic types of distilled products are white goods, brown goods, and specialties. White goods are clear or nearly clear in color, such as vodka, gin, rum, and tequila. Vodka accounts for the majority of U.S. market sales (just over 50%), then rum is No. 2 at 20%, and followed by gin and tequila. Brown goods are brown in color, and include various types of whiskeys, 60% of which are imported, and 25% is domestic bourbon. Bourbon is whiskey made in the U.S. from mash consisting of at least 51% corn. Rye is whiskey made from mash consisting of at least 51% rye, and usually from Canada. Scotch is whiskey made in Scotland, and Irish whiskey is made in Ireland, and both primarily from barley mash. Specialties range from high-priced cognacs and brandies, to ports and sherries, to imported liqueurs, to less expensive domestic cordials and ready-to-drink mixed drinks.[20]

Wine In 2004, U.S. wine consumption reached $23 billion, or 267 million cases (1 case = 9 liters, and 1 gallon = 3.785 liters). The top-five companies accounted for 76% of volume sales in the U.S. These are: E&J Gallo Winery (27%), Constellation Brands (22%), Wine Group Inc. (17%, and maker of No. 1 selling wine brand Franzia, a box wine selling 23.6 million cases), Beringer Blass Wine Estates (subsidiary of Foster's Brewing Group), and Trinchero Family Estates.[21] Constellation Brands gained ground on E&J Gallo Winery in 2004 by acquiring the previous No. 4, Robert Mondavi Winery, for $1.36 billion in November 2004.

But these numbers are misleading, as the wine market is much less concentrated than spirits or beer. Wine prices vary substantially with quality. Most of the volume sales are inexpensive jug and box wines. Small and medium size wineries sell a much higher percent of sales in terms of dollars. Furthermore, foreign competition is intense from Old World wine countries such as France, Italy, Spain, Portugal, and Germany, and also from New World wine countries such as South Africa, Australia, and Chile.

Like beer, wine has been enjoyed since the early days of civilization, and some believe that wine puts the "civil" in civilization. The various wine categories are table (90% in the U.S.), sparkling (5%), dessert and fortified (4%), vermouth and aperitif (1%), and wine coolers (less than 1%). Table wines contain 7% to 14% alcohol. Domestically produced wines account for two-thirds of wine consumed in the U.S.[22]

Wines are either varietals (single grape) or nonvarietals (blends of two grapes or more). Most New World wines are varietals and named for the varietal, while wines from France and Italy are typically nonvarietals and named for their region. Most states and countries have regulations governing the minimum percentage of a grape in a wine to

[19] *Adams Handbook Advance 2005.*
[20] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.
[21] *Adams Handbook Advance 2005.*
[22] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.

make the wine a varietal, which is usually 75%. For example, for a wine to be called cabernet sauvignon in California, California state law requires that at least 75% of the wine must be from that grape. Regions within France and Italy have regulations governing the makeup of both red and white wines from that region. For example, Bordeaux red wines must be made with the cabernet sauvignon grape as the primary grape, but leaves room for blending with other grapes, often blended with merlot. This creates similar tastes within regions, but allows for each winery to create its own distinct flavor. French wine connoisseurs often complain that New World wines all taste the same (an exaggeration, but a good point nonetheless).

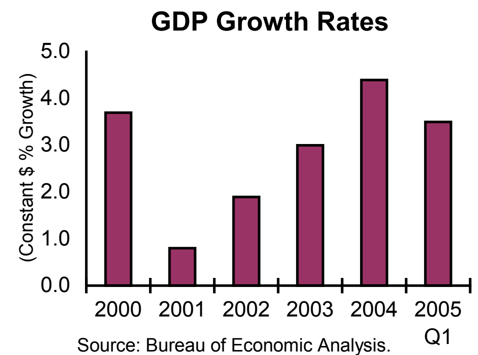
A grape glut occurred for three years, topping 3 million tons crushed from 2000 to 2002, causing California wine prices to drop 2.5% and revenue to go down 10% in 2003. Then 100,000 acres were eliminated in Central Valley, CA, in 2003. This caused grape supply to fall to 2.9 million tons crushed, and fell further in 2004 to 2.7 million tons crushed.[23] But increased foreign competition has kept prices down. But fortunately for wineries, wine consumption is up in the U.S., and wine drinkers have been moving up the quality scale into more expensive wines. Wineries purchase grapes from many vineyards to minimize poor harvests in any one. Most grapes are grown in California, with Oregon, Washington, and New York as significant grape producers. Many wineries have made alliances or purchased vineyards in Chile to further diversify against shortages.[24]

Once grapes are purchased, they are crushed at winery facilities and prepared for storage, then bottled. Inventories are usually highest in November and December, after the crush of each year's harvest. To have a vintage date, 95% of grapes must be harvested, crushed, and fermented in that year, and labeled with an appellation of origin. For an appellation of origin, at least 75% of the grapes must be grown in that area, such as Napa Valley. Like distilled spirits, wine is distributed through wholesalers or state-level alcoholic beverage control agencies.[25] However, a recent U.S. Supreme Court decision could open the door for more direct-to-consumer sales in many states.

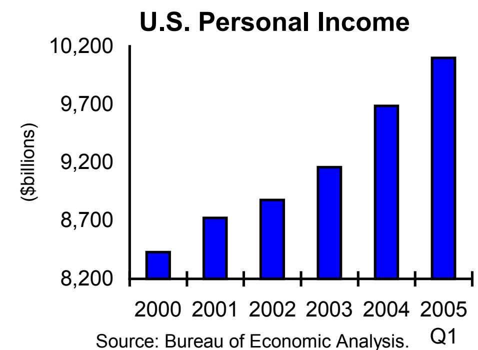
Economic Indicators

The quantity of beverages sold remains steady through economic cycles. However, the quality of products sold is directly related to disposable personal income. Consumers shift to private-label nonalcoholic beverages, house spirits, jug wine, and sub-premium beer during recessions. Large brewers are the least affected in downturns, since they produce sub-premium level beers, such as AB's Busch and Natural Light brands. Profit margins are lower for these brews, but they hedge against a full falloff in revenue and help keep capacity levels high. As the economy improves, large brewers raise prices of sub-premium beers, which encourages consumers to trade-up to higher-margin premium level brews, such as AB's Budweiser and Michelob. However, the upside for brewers is also limited, since many consumers will also trade-up to wine and spirits. Furthermore, as U.S. consumers increasingly acquire a taste for craft beers, trading-up to microbrews and imported beers is increasingly a threat to large brewers. This also explains their expansion into higher-premium brews and imports, such as Adolph Coors' Blue Moon Belgium White Ale, SABMiller's Pilsner Urquell, AB's Tequiza and 27% ownership in China's Tsingtao, and InBev's string of high quality beers from Bass Ale to Stella Artois.

[23] Wine Institute.
[24] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.
[25] Ibid.



After the recession of 2001, which yielded 0.8% real gross domestic product (GDP) growth in the U.S., the economy remained sluggish in 2002, with 1.9% GDP growth. The economy picked up in 2003 with 3.0% GDP growth, and more importantly grew robustly in the second half with 7.4% growth in the third quarter and 4.2% in the fourth quarter. GDP continued its strong showing in 2004, up 4.4%. But growth was tempered to a moderately strong level of 3.5% in the first quarter of 2005.[26] Many signs are pointing to continued moderate growth in the coming year. The index of U.S. Leading Economic Indicators rose significantly in 2003 and through May 2004. However, it declined for five consecutive months through October. It then rose 0.3% in November and December 2004. It then began a four-consecutive-month decline, falling 0.3% in January 2005, 0.1% in February, 0.6% in March, and an additional 0.2% in April to close at 114.5.[27] Despite the recent down results, it is important to note that the current level remains at a relatively high level, which generally indicates future growth.



Personal incomes have been rising. After years of growing at 5% to 8% in the late 1990s, personal income growth slowed to 2.3% in 2002, to $8.9 trillion. In 2003, personal income growth rebounded to a moderate rate of 3.2% to $9.2 trillion, and then soared 5.6% in 2004 to nearly $9.7 trillion. It then broke the $10-trillion mark in the first quarter of 2005.[28]

Given mixed but overall positive leading indicators and strong personal income, Advisen believes that the overall economy should have moderate growth for the next 12 to 18 months. Continued high budget deficits in the U.S. have had a deleterious effect on the trade deficit, causing the U.S. dollar to remain weak. This weakness, combined with high oil prices, has caused inflationary concerns, which is prompting the Federal Reserve to raise interest rates at the expense of growth. Furthermore, higher prices "at the pump" are having a somewhat negative impact on consumer purchasing power. Although interest rate increases will continue, they will not be aggressive, and act to temper economic growth in the U.S. from strong to moderate, particularly since the overall economic outlook remains mostly positive.

A growing economy should prompt continued trading-up into higher-quality beverages, particularly for wine and spirits. The growth of beer revenue can be tempered for large brewers as microbrews, such a River Horse Brewery Company in Lambertville, NJ, continue to grow in popularity. However, most large brewers have diversified into higher quality and imported brews to tap into this market, and these beers will continue to benefit from advertising and get shelf space on a national level due to their distribution advantages over microbreweries.

Large nonalcoholic beverage makers can benefit from continued growth in personal incomes, keeping consumers from sliding into private-label brands. But as incomes rise, consumers seem eager to experiment with newer, nontraditional types of beverages. This presents an opportunity for hot new start-ups and a challenge for industry behemoths, such as Coca-Cola and PepsiCo.

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[26] Bureau of Economic Analysis.
[27] The Conference Board.
[28] Bureau of Economic Analysis.

Top Companies

The following table is a list of the top-20 global beverage makers and distributors, by revenue.

Top-20 Global Beverage Makers and Distributors, by Revenue

Company	Other Information	FYE	Rev ($mil)
PepsiCo Inc. (U.S.)	No. 2 soft drink maker. Pepsi, Diet Pepsi, Mountain Dew, Sierra Mist, Slice, Aquafina, SoBe, Gatorade, and Tropicana, and licensed Lipton ready-to-drink teas and Dole juices. Also owns Frito Lay and Quaker Oats. Owns 43% of The Pepsi Bottling Group Inc. and 41% of bottler PepsiAmericas Inc.	Dec 2004	29,261
Coca-Cola Company (U.S.)	No. 1 soft drink maker. Coke, Diet Coke, Fanta, Sprite, Barq's, Frutopia, Minute Maid, Simply Orange, Odwalla, PowerAde, Nestea ready-to-drink teas, and Dasani. Sells Groupe Danone's spring water brands in North America. Owns 36% of bottler Coca-Cola Enterprises Inc. and 24% of Coca-Cola Hellenic Bottling Co.	Dec 2004	21,962
Coca-Cola Enterprises Inc. (U.S.)	No. 1 bottler and distributor for Coca-Cola. Also bottles and distributes other brands. 36% owned by Coca-Cola.	Dec 2004	18,158
Diageo Plc (U.K.)	Formed from 1997 merger of Guinness and Grand Metropolitan, and added more with the 2001 acquisition of 60% of Seagram's spirits from Vivendi Universal. No. 1 maker of alcoholic beverages and No. 1 distiller of spirits. Guinness, Harp, Johnnie Walker scotch, Tanqueray gin, Smirnoff and Gordon's vodka, Jose Cuervo tequila, Captain Morgan rum, Crown Royal and VO whiskeys, and Seagram's coolers and mixers. Owns 34% of LVMH Moet Hennessy Louis Vuitton, which makes Dom Perignon, Moet & Chandon, Veuve Clicquot, and Hennessy.	June 2004	16,161
Kirin Brewery Co. Ltd. (Japan)	No. 2 Japan brewer. Kirin Lager, Ichiban Shibori, and Kirin Tanrei. Makes canned coffee and tea, fruit juices, flavored water, and soft drinks.	Dec 2004	15,307
Anheuser-Busch Companies, Inc. (U.S.)	No. 1 brewer by brewery revenue, but No. 2 by volume. Bud, Bud Light, Michelob, Michelob Ultra, Busch, Natural Light, Tequiza, ZiegenBock Amber, Doc's Hard Lemon, American Red, Redhook (30%), O'Doul's, 50% of Grupo Modelo (Corona), 27% of Tsingtao, and License to brew Kirin in U.S. Owns theme and amusement parks.	Dec 2004	14,934
Asahi Breweries Ltd. (Japan)	No. 1 Japan brewer, and No. 1 Japan beer in Super Dry. Sister company produces canned coffee and tea, fruit juices, flavored water, and soft drinks. Imports Miller, Lowenbrau, and Bass.	Dec 2004	14,008

Sources: Advisen Ltd. company information and Hoovers.com.

Top-20 Global Beverage Makers and Distributors, by Revenue (Continued)

Company	Other Information	FYE	Rev ($mil)
Heineken NV (The Netherlands)	Heineken, Amstel, Murphy's, Buckler (Europe), Quilmes (Argentina), Moretti (Italy), Tiger (Asia), Zagorka (Bulgaria), and Bochkaryov (Russia). Distributes soft drinks.	Dec 2004	13,647
Suntory Ltd. (Japan)	Leading whiskey maker in Japan. Also beer, wine, and nonalcoholic beverages. Imports alcoholic beverages.	Dec 2003	12,323
Pepsi Bottling Grp. (U.S.)	No. 1 bottler and distributor for PepsiCo. PepsiCo owns 43%.	Dec 2004	10,906
InBev S.A. (Belgium)	Beck's, Bass, Stella Artois, Hoegaarden, Labatt Blue, Leffe, Rolling Rock, Labatt Sterling (low-carb), Absolut Cut. Interbrew merged with Companhia de Bebidas das Americas (AmBev), No. 1 in Latin America, in March 2004 in a deal worth $11 billion, which made it the No. 1 brewer by volume.	Dec 2004	10,651
SABMiller Plc (U.K.)	No. 2 U.S. brewer. SAB acquired Miller in 2002. Owned 36% by Altria Group (formerly Philip Morris). Miller, Miller Lite, MGD, Miller High Life, Red Dog, Meister Brau, Castle Lager, Hansa Pilsner, Ohlssons, Pilsner Urquell, Skyy Blue, and Stoli Citrona. Owns 29% of Harbin Brewery (No. 4 in China). Also makes wines, spirits, and fruit drinks, and bottles soft drinks.	Mar 2005	10,606
Scottish & Newcastle Plc (U.K.)	No. 1 brewer in Europe (for breweries located in Europe). Courage, John Smith's, Kronenbourg, McEwan's, Newcastle.	Dec 2004	8,537
Fomento Economico Mexicano (Mexico)	Beer sub makes Bohemia, Carta Blanca, Dos Equis, Sol, and Tecate. Bottles for Coca-Cola through 46% owned Coca-Cola FEMSA subsidiary (No. 2 Coca-Cola bottler).	Dec 2004	8,433
Carlsberg A/S (Denmark)	Beer brewer.	Dec 2004	6,596
Allied Domecq Plc (U.K.)	No. 2 distiller. Ballantine's scotch, Beefeater gin, Kahlua and Tia Maria liqueurs, Sauza tequila, Canadian Club and Maker's Mark whiskeys, Malibu rum, and Courvoisier cognac. Also owns Baskin-Robbins and Dunkin' Donuts, and Togo Eateries. Pernod Ricard and Fortune Brands agreed to acquire it for $14.2 billion.	Aug 2004	5,823
Coca-Cola Hellenic Bottling (Greece)	No. 3 bottler for Coca-Cola, after Coca-Cola Enterprises and Coca-Cola FEMSA). 24% owned by Coca-Cola	Dec 2004	5,692
Pernod Ricard S.A. (France)	No. 3 spirits distiller. Acquired 40% of Seagram's spirits. Wild Turkey whiskey, Pernod Ricard liqueur, Altai vodka, Havana Club rum, Seagram's gin, Chivas Regal scotch, The Glenlivet scotch, Jameson Irish whiskey, Martel cognac, Jacob's Creek wine. Agreed to acquire Allied Domecq with partner Fortune Brands for $14.2 billion.	Dec 2004	4,872

Sources: Advisen Ltd. company information and Hoovers.com.

Top-20 Global Beverage Makers and Distributors, by Revenue (Continued)

Company	Other Information	FYE	Rev ($mil)
Sapporo Holdings Ltd. (Japan)	No. 3 brewer in Japan. Black Label and Yebisu. Imports Guinness in Japan. Owns nonalcoholic beverage company.	Dec 2004	4,800
Molson Coors Co. (U.S.)	No. 3 brewer in U.S. and No. 5 in the world by volume. Adolph Coors Co. merged with Molson Inc., No. 1 brewer in Canada, in January 2005, bringing Canadian and Brazilian breweries. The deal was worth approximately $6 billion. Coors, Coors Light, Blue Moon Belgian White Ale, George Killian's Irish Red Lager, Keystone, Aspen Edge (low-carb), Carling, Zima, Coor's Non-Alcoholic, Molson Golden.	Dec 2004	4,306

Other Notable Companies

The following table is a list of food product industry companies and one conglomerate, all with significant operations in the beverages industry.

Other Notable Companies Involved in Beverages, by Revenue

Company	Other Information	FYE	Rev ($mil)
Nestle S.A. (Switzerland)	No. 1 bottled water producer in world. Perrier (No. 1 bottled water brand in world), Poland Spring, Vittel, San Pellegrino, Deer Park, Great Bear, and many other bottled water brands. Beverages only was $17 billion in revenue (but includes powder iced teas and instant coffee, which is part of the food products industry)	Dec 2004	76,660
Groupe Danone (France)	No. 2 bottled water producer in world. Evian (No. 2 bottled water brand in the world), Volvic, and Aqua water. Beverages only revenue was $3 billion. Also, yogurt drinks.	Dec 2004	18,558
Cadbury Schweppes plc (U.K.)	No. 3 soft drink maker in world. 7 Up, 7 Up dnL, A&W Rootbeer, Stewart's sodas, Canada Dry, Dr. Pepper, Snapple, Mistic fruit juices, Orangina, Yoo-Hoo, Pampryl fruit juices, Hawaiian Punch, Deja Blue, Red Fusion, Sunkist, Schweppes, Squirt, Country Time, Squirt, Nehi, RC Cola, Diet Rite, and Welch's juices. Beverages only revenue was $4 billion.	Dec 2004	12,918
Fortune Brands, Inc. (U.S.)	Leading U.S. producer and distributor of distilled spirits (Jim Beam, Knob Creek, and Absolut within U.S.). Also involved in golf equipment and home products. Bidding with Pernod Ricard to acquire Allied Domecq for $14.2 billion. Beverages only revenue was $1 billion.	Dec 2004	7,021

Sources: Advisen Ltd. company information and Hoovers.com.

Business Environment

The beverages industry is a global business, influenced by varying taste trends and globalization. Consumers in the U.S. are trading-up to spirits, wine, and high-quality craft beers, at the expense of mass-produced lagers. Tepid growth in alcohol drinking in developed countries has led to rapid consolidation and globalization of brands, in addition to aggressive expansion into developing markets. Traditional nonalcoholic beverages have areas of growth, but have mostly experienced lackluster growth. Most growth in nonalcoholic beverages is occurring in the alternative beverages area. The "low-carb" trend has hit the beverages industry, and it is transitioning into "low-cal."

Trade-Up in Alcoholic Beverages Hurts Large Brewers

An aging U.S. population, particularly Baby Boomers reaching their senior years, and rising disposable incomes, are forces driving consumers to trade-up from beers to spirits and wines. This is especially true for premium wines and spirits, at the expense of mass-produced beers. Craft and imported premium beers also benefit from this trend.

As with many consumer products, Americans are becoming more upscale in their selection of alcohol. This societal trend can be seen in products across-the-board. Williams-Sonoma is replacing Sears for housewares, coffee drinkers are choosing Starbucks over diners, and Hershey's chocolate bars are being tossed aside for European style chocolates. Alcohol is merely the latest product to undergo "yuppie-fication," as luxury goods purveyors are thriving at the expense of suppliers of staples.[29] Distilled spirits and winemakers have benefited from this trend. The U.S. Supreme Court has ruled that the wine distribution laws in New York and Michigan are unconstitutional because they favor in-state distributors. This ruling could potentially free-up in-state distribution networks to more direct-to-consumer wine shipments, making wine more affordable, and perhaps contributing to this trend.[30]

However, the trading-up trend does not apply only to Baby Boomers. It is happening in all age groups, and most surprisingly for young drinkers. Generation Y, born between 1977 and 1994, is entering its drinking years. New drinkers are important for marketers to capture, because brand loyalty is often developed at a young age. People often like to drink the favorite drinks of their youth, or at least trade-up to premium brands of the same maker. So marketers are focusing on the 21-to-27-age-group. Generation Y is a mini-baby boom, making up 25% of the U.S. population.[31] This is normally good news for beer makers, but this time around much has changed.

Young drinkers are choosing spirits and wine. Spirits distillers are marketing ready-to-drink flavored cocktails, hard lemonade, hard iced tea, flavored vodkas, and malt-based drinks. These items are less expensive and more convenient than premium distilled spirits, and their sweet flavors appeal to new drinkers. The removal of the U.S. electronic advertising ban for distilled liquors in 1996 has certainly impacted sales to young drinkers. Television advertising by spirits companies has increased ten-fold in four years, from $400,000 in 1999 to $40 million in

[29] "Welcome to Miller Time, Loser," *Slate*, May 2, 2005.
[30] "Supreme Court Lifts Ban On Wine Shippers," *The New York Times*, May 17, 2005.
[31] U.S. Census Bureau.

2003, and 2004 is expected to have increased by 25%.[32] In addition, intense competition from international wines has made wine more affordable, sparking young drinkers to acquire a taste for wine.

In 2004, wine consumption by volume was up 4%, spirits up 4%, and beer up 1.5% after a down year in 2003.[33] This was a direct result of the trading-up trend and appeal to youth. Distillers are increasingly coming out with new flavors and drinks to match. For example, Absolut vodka now comes in seven different flavors, which made up 12% of all of its vodka sold in the U.S. in 2004.[34] Absolut has come up with "signature drinks" and an advertising campaign to promote them.

Brewers have responded with clear malt-based products, such as Zima (Coors), Bacardi Silver (AB), and Skyy Blue (SABMiller), which appeals to young drinkers choosing ready-to-drink flavored cocktails. But this also helps to develop brand loyalty to the partner spirit, such as Bacardi rum and Skyy vodka. Some brewers are experimenting with new forms of beer. AB introduced B^E (pronounce "B-to-the-E") in late 2004, which is a fruity-smelling beer, spiked with caffeine, guarana, and ginseng, and packed with 2003 calories. It is meant to appeal to 20-somethings, who have an affinity for energy drinks as part of mixed alcoholic drinks, such as mixing with Red Bull.

Also, beer has been hurt by the low-carb trend, and young people have been particularly in-tune with this trend. Beer companies have responded with low-carb beers and increased advertising highlighting the low-carb qualities of light beers. Breweries are hoping that the ready-to-drink fad will pass, and that their low-carb beers will produce long-term brand loyalty with young drinkers. However, distillers are creating low-calorie versions of flavored alcohol, such as Bacardi's Island Breeze flavored rum. It has 70% fewer calories than most flavored alcohol, like Absolut's flavored vodkas, because it is sweetened with sucralose and has less alcohol.

But not all beer sales are down. Craft beers are growing in popularity, but more so with older generations. This is a trend that helps microbrews and imported premium beers. The top-10 beer imports increased in volume sales by 3.5% in 2003, following a 6.5% increase in 2002. The top-10 U.S. beer brands were down in volume sales 0.4%.[35] In 2004, beer imports increased 4% in terms of revenue, while overall beer revenue was flat.[36] This trend is in part responsible for the consolidation of international beer markets, where large breweries are picking up global premium beer brands, and beginning to develop premium-level beers organically. For example, Adolph Coors acquired Carling from Interbrew (now InBev), and owns Blue Moon Belgian White Ale and George Killian's Irish Red Lager. SAB Miller acquired Pilsner Urquell and Castle Lager. AB owns 30% of Redhook. InBev has rounded up a string of strong international brands, including Beck's, Stella Artois, Hoegaarden, and Bass.

These large brewers have advertising and distribution advantages over microbreweries. But microbreweries have small brewery charm. When consumers trade-up for higher quality beers, they are looking for a hand-crafted personalized touch with distinguishing tastes. Large brewers were able to dominate the mass-produced lager market because, in addition to advertising and distribution, most of these beers taste almost alike. A small brewer with the same tasting beer, without advertising and distribution clout, and higher costs due to economies of scale disadvantages, never had a chance against the large brewers.

But microbrews have niches to serve in the premium beer market, where people are willing to pay more for individual flavors, which can at times lead to national opportunities. For example, Anchor Brewing Company

[32] *Impact*.
[33] *Adams Handbook Advance 2005*.
[34] "Vodka Goes Beyond Plain Vanilla," *The New York Times*, June 16, 2005.
[35] *Adams Handbook Advance 2005*.
[36] Internal Revenue Service.

(maker of Anchor Steam and Liberty Ale) of San Francisco, CA, appears to have established a national following (including the author of this report), and is now expanding internationally into Canada, Hong Kong, Japan, The Netherlands, and the U.K. Although the large breweries have advantages over microbrews, they will not be able to completely dominate this market as before. Microbrews will continue to be a thorn in the side of large breweries as consumers increasingly look for distinguished tastes, much like small wineries have always been able to coexist with large wineries.

Consolidation and Globalization

Slow growth in alcoholic beverage consumption in developed markets has prompted large companies to consolidate globally, to leverage advertising and economies of scale. Consolidation by alcoholic beverage players allows companies to become more efficient by expanding their portfolio of brands and strengthening their distribution networks. The purchasing power of Wal-Mart is a major driver of this trend, since Wal-Mart is controlling a higher share of shelf-space, particularly in the U.S.[37]

Although growth has been slow, profit margins remain high due to barriers to entry, allowing companies to expand globally. Furthermore, part of the globalization trend is an attempt to expand into developing markets, particularly in Asia, Eastern Europe, and Latin America, which are markets expected to have rapid growth. Consolidation is taking the forms of direct acquisitions, purchasing significant ownership stakes, joint ventures, and alliances.

Spirits distillers had a significant consolidation with the forming of Diageo in 1997. Diageo was formed from merging Guinness and Grand Metropolitan, then the subsequent acquisition of 60% of Seagram's spirits by Diageo in 2001 and 40% by Pernod-Ricard for $8.15 billion. An interesting recent acquisition was Bacardi's purchase of Grey Goose vodka from Sidney Frank Importing Co. for $2 billion in June 2004.[38] This gives the owner of popular rums, flavored alcohols, Dewer's Scotch, and Bombay Sapphire gin, access to the fast growing premium vodka arena. Look for flavored Grey Goose vodkas, much like those made by Absolut. Another distiller acquisition that will soon take place is the purchase by Pernod Ricard S.A. and Fortune Brands of Allied Domecq for $14.2 billion, which was recently approved by the E.U. This acquisition is meant to provide substantial competition to the behemoth-sized Diageo.[39]

Large wineries are always acquiring smaller wineries to expand brands and stay fresh with the latest varietals and methods. For example, Southcorp, of Australia, acquired Rosemount Estates in 2001, but was soon after troubled from a drought. Foster's Group, which owns Beringer Blass Wine Estates, acquired Southcorp for $2.5 billion in May 2005.[40] This underscores that spirits and beer companies are increasingly purchasing wineries, such as Foster's Group and Constellation Brands.

[37] "Fewer Carbs and Cals, More Ads," *The Wall Street Journal*, November 22, 2004.
[38] "Fewer Carbs and Cals, More Ads," *The Wall Street Journal*, November 22, 2004.
[39] Yahoo! Finance.
[40] "Foster's Wins Southcorp Fight," *The Australian*, May 27, 2005.

Some recent major U.S. winery acquisitions include:[41]

- September 2002 – E&J Gallo Winery acquired Louis M. Martini winery in Napa;
- September 2002 – E&J Gallo Winery acquired Mirassou Vineyards in San Jose;
- November 2004 – Constellation Brands Inc. acquired Robert Mondavi Winery for $1.36 billion; and
- December 2004 – Diageo plc acquired Chalone Group for $260 million.

Despite these consolidation and globalization moves by spirits and wine companies, most of the action has happened, and will likely continue to happen, in the beer domain. In 1980, the top-10 global brewers accounted for less than 25% of global sales. By 2003, the top-10 represented 55% of sales.[42] Global brewers have been purchasing international brands. International beers are beers with international brand images, such as Beck's and Bass Ale, acquired by Interbrew (now InBev). These beers are easily exported.

But often beer does not appeal to international tastes. Beer, as with food, is provincial, reflecting local taste preferences, distribution networks, and trade barriers. Therefore, beer companies have relied on multiple approaches to globalization, such as developing joint ventures with local brewers and distributors, and taken on equity interests in local brewers. So the global beer market has become more international in ownership and supply, despite being locally-driven demand.[43]

The big-three U.S. brewers are now significantly involved in global markets. AB has made deals in China, Japan, Brazil, Chile, Argentina, India, Italy, France, Switzerland, and Spain. It has joint ventures in Chile's Compania Cervecerias Unidas S.A. and Agentina's Buenos Aires Embatelladora S.A. In 1998, AB increased its ownership to just above 50% in Grupo Modelo S.A., Mexico's largest brewer and maker of Corona, and recently increased its stake in the No. 1 brewer in China, Tsingtoa, to 27%. AB has a license agreement with Kirin brewery to produce Kirin beer in the U.S.

Miller Brewing Company (part of SABMiller) has alliances with brewers in Japan, Brazil, China, and the U.K. It has a joint venture with Brazil's Companhia Cervejarias Brahma. SAB (of the U.K.) became the world's No. 2 brewer when its acquired Miller and formed SABMiller in July 2002, combining the Miller line of beers with many internationally recognized brands such as Castle lager, Hansa Pilsner, and Pilsner Urquell.

Molson Coors Brewing Company became a global brewer in a big way with the merger of Adolph Coors Co. and the Molson Inc., the No. 1 Canadian brewer, completed in January 2005. Molson Coors exports to, and operates facilities in, Canada, the U.K., Australia, The Netherlands, Ireland, Japan, Brazil, and the Caribbean Islands. It has also stepped up international activities by establishing licensing agreements with international brewers. The company was lagging in international sales up to 2001, when only 4% of sales were from outside the U.S. But its acquisition of Carling from Interbrew (now InBev) in 2002 bumped up non-U.S. sales. Its Carling business now represents 40% of sales, and holds 19% of the U.K. beer market.

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[41] "Small Wineries Being Acquired by Big Names," *The New York Times*, December 29, 2004.
[42] *IMPACT*.
[43] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.

Feeling the same slow growth prospects as U.S. brewers, Europe has been the focus of intense consolidation over the past few years. These mergers and acquisitions have improved distribution capabilities, lowered costs, increased diversification, enhanced growth prospects, and reduced competition.[44]

The following is a list of significant mergers and acquisitions by European brewers over the past few years.[45]

- 2000 – Interbrew (of Belgium) acquired Bass Brewers and Whitbread Plc, which prompted U.K. regulators to order the sale of Carling.

- August 2001 – Interbrew acquired Germany's Beck GmbH & Co. (beating out Scottish & Newcastle and AB) for $1.58 billion. This gained access to Germany with their only major brand in the highly fragmented German market. It also has international appeal. This completes an impressive group of internationally recognized beers, including Beck's, Bass, Stella Artois, Hoegaarden, Labatt Blue, Leffe, and, an odd U.S. favorite, Rolling Rock.

- February 2002 – Coors acquired Carling from Interbrew, and became the No. 2 brewer in the U.K. behind Scottish & Newcastle.

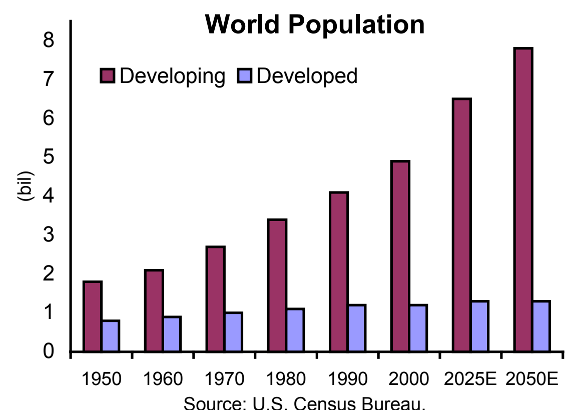
- July 2002 – South African Breweries acquired Miller Brewing Company from Philip Morris (now Altria Group) for $5.4 billion, to become the No. 2 global brewer behind AB. The new company, SABMiller, is 36% owned by Altria Group. The combined company is now strong in the U.S., Africa, China, Russia, Eastern Europe, and Central America.

- June 2003 – Heineken acquired Austria's Osterreichische Brau-Beteiligungs for $1.7 billion to form Brau Union, expanding into Central Europe.

- March 2004 – Interbrew announced its merger with Companhia de Bebidas das Americas (AmBev), which has 70% of Brazil's market and is substantial throughout Latin America. The name changed to InBev, creating the No. 1 global brewer, by volume. It gives InBev access to the fast growing Latin American market.

Developing Markets Seen as Large Growth Potential

A major part of globalization is expansion into developing markets, both selling and setting up operations. Asia, Eastern Europe, and Latin America are considered the key areas, as both population and incomes are rising in these markets. The growth in population is expected to continue into the foreseeable future. Developed markets offer stagnant alcoholic beverage consumption due to saturation and stagnant population growth.



[44] Ibid.
[45] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005; Hoovers.com; and Advisen.

However, wine and spirits makers mostly focus on exporting and setting up distribution and import partners in developing countries. Beer makers are actually setting up operations, making partnerships with local breweries, starting joint ventures with and taking equity stakes in local breweries, and purchasing distributors in developing countries. Wine and spirits production are considered more of an art than beer production, so production usually does not move to new markets. Furthermore, less expensive wine only sells to developing countries with wine traditions, such as Chile and Argentina. Countries without strong wine traditions usually do not open their drinking experiences to wine until they become developed, such as the growing popularity of wine in Japan. Similarly, spirits are mostly viewed as a trade-up for developed countries, with the exception of very inexpensive local brands. Therefore, other than in a few developing countries, wine and spirits have limited opportunities in developing markets compared to beer, particularly for setting up operations.

In China, a 1.3-billion population, rapidly growing economy, inexpensive labor, and a growing affinity for beer is making this the fastest growing beer market in the world. Per capita consumption is low (17.7 liters per annum, compared to 81.6 in the U.S., 97.8 in the U.K., 123.0 in Germany, and 159.0 in the Czech Republic). But overall consumption has tripled since 1990, reaching 23.5 billion liters in 2002. China has probably replaced the U.S. as the leader in overall consumption by now, which was 23.8 billion for the U.S. in 2002.[46] China's beer industry offers high growth opportunities, but it also experiences cutthroat competition from over 400 breweries. This means there is ample room for consolidation, and many breweries are tapping into foreign investment to roll up competitors.[47]

In the past three years, 35 joint ventures have been formed between local breweries and international brewers, which is the government's preferred way for foreign companies to invest in China.[48] In September 2003, Interbrew (now InBev) acquired a 50% stake in Malaysia's Lion Group for $131.5 million, which has operations (No. 3 in China) and sells in China. In 2002, Interbrew bought 24% of Zhujiang Joint Stock Company and 70% of KK Group, both in China. AB increased its ownership of Tsingtao (No. 1 in China) to 27% in 2004. Miller Brewing Company bought a 29% stake in China's No. 4 brewer, Harbin Brewery Group, in June 2002. Then in early 2004, AB also acquired 29% of Harbin, which set off a bidding war for control of Harbin, which AB eventually won for $650 million. Heineken increased its holdings in China in 2004 by investing in Guangdong Brewery, with the intention of brewing its flagship beer in China. Large firms have also been investing in companies in the rest of Asia, such as InBev holding a minority interest in Oriental Brewery of South Korea, maker of OB Lager.

Eastern Europe is another growth area. In addition to growing economies, it is an established beer-drinking region. As incomes rise, consumers are more than willing to spend it on the frothy brew. Five Eastern European countries are among the top-20 per capita consumers of beer, with the leader in the world being the Czech Republic at 159 liters per annum.[49] Heineken's acquisition of Austria's Osterreichische Brau-Beteiligungs for $1.7 billion, forming Brau Union, is a move into this market.[50] Russia has been a top beer-growth country over the past few years, where the industry is consolidating with investments from Heineken and InBev.

Latin America and Mexico are expected to have strong growth. Increasing incomes, with many pockets quickly becoming developed, and growing beer popularity, are driving these markets. Consumer preferences are even shifting in traditional wine markets, such as Argentina and Chile, to beer. Only a handful of local brands are established in the region, so international brands have ample opportunities to establish themselves in this nascent

[46] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.
[47] "Belgian Brewer Taps China Beer Market," China Daily, September 8, 2003.
[48] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.
[49] Ibid.
[50] "Beverages," Hoover's Online.

market. Interbrew's merger with Brazil's AmBev, creating the No. 1 global brewer InBev, and AB's 50% stake in Mexico's Grupo Modelo, are clear moves into this market. More moves are expected to follow in the near future.

U.S. wineries are also expected to gain in the Mexican market, as NAFTA called for the elimination of the 20% tariff on wine in 2004. Furthermore, U.S. wineries will continue their increased level of partnerships with Chilean wineries and vineyards, offering a perfect seasonal and climatic complement. Japan is a growing, but still small, market for wine. However, tastes are changing toward wine in Japan, and this coupled with deregulation of alcohol retailing presents growth potential for global winemakers. This is particularly true for New World wineries due to the growing affinity for these wines in Japan.[51] China presents long-term growth potential, giving its large size and growing affluence with an emerging middle class. As some people in China have accumulated wealth, they have shown a desire to experience the finer pleasures of Western civilization.

Traditional Nonalcoholic Beverages See Sluggish Growth

Traditional nonalcoholic beverages include soft drinks, bottled water, juice, and ready-to-drink iced tea. In contrast, alternative beverages include sports and energy drinks, but also overlaps with traditional beverages in certain areas, such as enhanced waters, teas, and juices, and originally flavored juices and soft drinks. Other than in a few areas, traditional beverages have met sluggish growth due to saturation.

Soft Drinks Soft drinks are the top dogs in the beverage world, accounting for 27.0% of all beverages consumed by volume, including alcoholic beverages, which is up from 25.9% in 1991. In 2004, soft drinks increased sales by $2 billion, or 3.0%, to $65.9 billion in the U.S. But volume grew less than 1% in 2004 to 52.3 million gallons, which has mostly been flat since 1999. In 2004, Coca-Cola held 43.1% of this market (down 0.9% from 2003), PepsiCo was at 31.7% (up 0.1%), and Cadbury Schweppes was at 14.5% (up 0.2%).[52] Cadbury Schweppes is attempting to become more in line with Coca-Cola and PepsiCo, acquiring many popular niche brands in many nonalcoholic beverage areas, such as its acquisition of Seagram's old soft drink line, from Pernod-Ricard, for $640 million, which included Yoo-Hoo, Orangina, and Pampryl fruit juices.

While these numbers might be impressive in shear size, soft drinks are considered to have reached the point of saturation. It is the largest growth area in terms of total growth because its numbers are so large, but fairly flat in terms of percentage, particularly volume growth. Furthermore, it is the alternative soft drink areas that have accounted for most growth, such as Red Bull energy drinks and original flavors such as Sprite Remix, which are included in these numbers. Also, a major growing area is private-label brands, much to the chagrin of the big-three soft drink makers. Cott Corporation supplies private-label brands to major supermarket chains and Wal-Mart, which saw volume sales grow 14% in 2003, and an additional 18% in 2004, to 564.9 million cases.[53]

But one area within the traditional soft drink area that is growing is the diet area. Buoyed by the low-carb craze and long-term trends toward diet soft drinks, these beverages are outpacing their regular-calorie brethrens. Diet Coke was up 5.0% in both 2003 and 2004 to 998 million cases, and Diet Pepsi was up 6.1% in 2003 and 6.7% in 2004 to 625 million cases. Coke has been introducing special flavored versions of Diet Coke, such as Diet Coke with lemon and more recently, with lime twists. Another soft drink growth product was Sierra Mist, a new lemon-flavored soft drink from Pepsi, which grew 88.0% to 140 million cases in 2003 (although it was down 1% in 2004),

[51] "Alcoholic Beverages & Tobacco," Standard & Poor's Industry Surveys, March 31, 2005.
[52] *Beverage Digest*.
[53] Ibid.

at the expense of 7 Up, which dropped 27.6% to 126.3 million cases in 2003. 7up dropped out of the top-10 carbonated soft drink list in 2004 for the first time since *Beverage Digest* tracking began in 1985.[54]

Bottled Water Bottled water has been a growing area for traditional beverages, which led in terms of percentage growth and was second in terms of total growth. In 2004, single-serve bottled water (1.5 liters or less) surged 19% in volume to 2.77 billion gallons in the U.S. In revenue terms, bottled water grew 14% to $11.4 billion. With bulk packages, per capita bottled water consumption reached 17.7 gallons per year in 2004, up from 16.6 gallons in 2003, and 8.0 gallons in 1991.[55] Bottled water has been growing due to concerns about municipal water safety, interest in healthy living, and increased affluence.[56]

By brand, Aquafina (PepsiCo) is No. 1 in the U.S. (13.6% market share), Dasani (Coca-Cola) is No. 2 (12.1%), and Poland Spring (Nestle) is No. 3 (11.7%). But in terms of company, Nestle is by far No. 1, with about one-third of the market, selling Poland Spring, Perrier, Great Bear, Vittel, Deer Park, and San Pellegrino among other brands. Danone and Coca-Cola together are the No. 2 companies for bottled water, with 9.7% each for a total of 19.4% market share. Coca-Cola distributes Danone bottled water brands in the U.S., which include Evian, Dannon, and Volvic, among others. Coca-Cola sells Evian as a premium-level product, priced at an index of 221.8% (the average market price = 100%). Dasani is priced at 127.1%, and Dannon at 84.9% or just above private-label water at 77.8%. PepsiCo's Aquafina has 13.6% market share, priced at 109.9%, and private-label brands are at 12.5% market share.[57] Globally, Nestle and Danone are by far No. 1 and No. 2 sellers of bottled water, respectively. Coca-Cola has aborted its release of Dasani in Europe after an embarrassing recall involving contaminated water in the U.K.[58]

However, private label brands have been growing the fastest of all brands, prompting price cuts for most brands across-the-board to maintain market share. These price cuts underscore a growing problem for bottled water. Although bottled water is growing in popularity, brand loyalty is low. According to a Morgan Stanley survey of 1,800 consumers, "brands play a weak role in the water category," with just 10% of consumers choosing water based on brand. Prices prove to be more important, coming in at 38% for choosing water products, as opposed to 26% for soft drinks.[59] It appears that consumers have finally come to the realization that most brands of water taste nearly identical. This does not bode well for the continued revenue growth of this area, nor does it bode well for the big-three soft drink companies hoping to extend their brand dominance from the stagnant growth soft drink area to the growing bottled water area. This had led to the development of enhanced waters, which are considered alternative beverages.

Juices Juices make up the No. 3 nonalcoholic beverage category. U.S. sales in this area grew an anemic $38 million to $6.4 billion in 2004, after a down year in 2003. In volume, juice consumption was 1.2 billion gallons in 2004, up 3.1% after dropping 3% in 2003.[60] This area grew in the 1990s due to rising health concerns for soft drinks, and an aging population in search of more vitamins in beverages.[61] But that's due to its close tie-in to many alternative beverages, such as originally flavored juices and enhanced juices. However, juices have potential for growth as Baby Boomers continue to seek out healthier alternatives to carbonated soft drinks.

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[54] Ibid.
[55] Ibid.
[56] "Food & Nonalcoholic Beverages," Standard & Poor's Industry Surveys, June 9, 2005.
[57] "Only Dannon and Private-Label Gain Share," *Beverage Digest*, July 11, 2003.
[58] "Behind Coke's CEO Travails: A Long Struggle Over Strategy," *The Wall Street Journal*, May 4, 2004.
[59] "Water: MS Study Finds Low Brand Loyalty," *Beverage Digest*, June 7, 2002.
[60] *Beverage Digest*.
[61] "Food & Nonalcoholic Beverages," Standard & Poor's Industry Surveys, June 9, 2005.

Ready-to-Drink Teas This area is the fifth largest nonalcoholic beverage category, after No. 4 sport drinks (discussed in the "Alternative Beverages" section below). In 2004, sales were up $248 million, or 7.8%, to $3.2 billion in the U.S. Consumption was up 4.2% to 580.5 million gallons.[62] This area dropped in 2002 and 2003 as a direct result of the increased popularity of functional teas, containing herbs and other ingredients, which are considered alternative beverages. However, it rebounded in 2004 from a resurgence by premium tea brands, such as Arizona and Snapple, who now offer such functional teas in their portfolio of products.

Alternative Beverages Expand Rapidly

Alternative beverages include sports drinks, energy drinks, functional teas, enhanced water, originally flavored and enhanced (functional) juices, ready-to-drink coffees, yogurt and other dairy drinks, smoothies, and originally flavored soft drinks. These brands have differentiated themselves from traditional beverages with quirky ads, unconventional packaging, and changing taste combinations. They are often distributed by independent companies with expertise in low-drop-off/high-restocking-frequency customers, such as delis, convenience stores, and schools.[63]

Sports drinks are the No. 4 nonalcoholic beverage group, and the largest alternative beverage. Pepsi entered this area in a big way with its acquisition of Quaker Oats, which owned Gatorade. Gatorade has the lion's share of the market, with its nearest competitor being Coca-Cola's PowerAde.[64] In 2004, U.S. sales were up 17%, to $5.4 billion. Volume sales increased 16% to 1.02 billion gallons. Per capita consumption reached 3.5 gallons per year, up from 3.0 gallons in 2003. But this growth is much slower than in the recent past. From 1993 to 1999, per capita consumption in the U.S. increased from 0.9 gallons per year to 2.1 gallons. The reason for the slowed growth is a reduced level of exercising, the growth of bottled water, the rapid growth of energy drinks, and the low-carb trend hurting sales of this high-calorie drink. But sales remain strong, as producers convince consumers that sports drinks are for more than just exercising.[65]

Functional teas and juices are infused with herbs, vitamins, and other additives that supposedly reduce stress, increase concentration, and improve endurance.[66] Tea and juice drinkers almost need a degree in pharmacy to decipher some of the ingredients and health claims. Examples of herbs include ginseng, kava kava, and ginko biloba, with green teas becoming increasingly more popular. This area has grown from $2.1 million in 1996 to over half a billion in 2004.[67] Examples of leading brands in this area are Snapple (Cadbury Schweppes), Arizona Iced Tea (and juices), Mistic (Cadbury Schweppes), Fruitopia (Coca-Cola), and SoBe (PepsiCo). Many of these are also stalwarts of traditional teas and juices. But new and independent competition is sprouting up from all corners, such as Kalahari Ltd's Kalahari Red Tea. The company claims that the tea's antioxidants, potassium, and other minerals can relieve allergy symptoms.[68] Another interesting newcomer is Pom Wonderful, maker of a pomegranate juice, advertising the health benefits of this fruit.

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[62] *Beverage Digest*.
[63] "Food & Nonalcoholic Beverages," Standard & Poor's Industry Surveys, June 9, 2005.
[64] "Beverages," Hoover's Online.
[65] "Food & Nonalcoholic Beverages," Standard & Poor's Industry Surveys, June 9, 2005.
[66] "Beverages," Hoover's Online.
[67] *Beverage Digest*.
[68] "Fewer Carbs and Cals, More Ads," *The Wall Street Journal*, November 22, 2004.

Some other enhanced juices include pureed blends, such as Odwalla (Coca-Cola), Snapple-a-Day (Cadbury Schweppes), and Naked. These juices are also often fortified with vitamins, herbs, and extracts, and offer interesting blends of fruit flavors. Also, meal-replacement fruit juices have entered the market, with many companies coming out with soy-based (nondairy) pureed juice shakes, such as Snapple-a-Day's and Odwalla's high-protein shakes.

Enhanced waters have vitamins, herbs, electrolytes, and other ingredients. Some are lightly flavored, and other types are oxygenated water and caffeinated water. This is a growth area that offers value-added attributes for bottled water-makers. Energy Brands Inc. has leading products in this area called Glaceau Vitamin Water and Glaceau Smart Water, which took the big-three soft drink makers by surprise. Fiji Water, by independent Fiji Water LLC has been a hit, advertised as natural artesian water drawn from pristine aquifers in the South Pacific that are rich in colloidal silica, claimed to enhance tissue repair.[69] The big-three soft drink makers are fighting back with lightly-flavored waters of their own, such as Dasani Lemon and Raspberry variants, launched in 2005 by Coca-Cola.

Another growing, but relatively small, area is dairy-based beverages, smoothies, and yogurt drinks. Danone and other yogurt companies have lines of new yogurt drinks, while soft drink companies are entering the dairy-based drink field. For example, Coca-Cola has created Swerve, which is a drink made of 50% milk with the same number of calories as an 8-oz. serving of low-fat chocolate milk (150 calories), is cholesterol-free, and supplies 30% of the recommended daily intake of calcium and vitamins A and C.[70] It is marketed to children, supplied in school vending machines, branded with a cartoon cow in shades, and has unique flavors such as Bloo (blueberry and strawberry) and Vanana (vanilla and banana). Nestles' NesQuick and Hershey, old-timers in the dairy-based beverage field, are offering milk-based drinks in new flavors and served in new bottles with attitudes. Smoothies are blends of pureed fruit juices and yogurt, such as Tropicana Smoothie (PepsiCo).

Also, a nascent and smaller field is ready-to-drink coffees, with Starbucks and established brands in Japan leading the way in the U.S. market. Celebrity chef Wolfgang Puck has entered this field with a line of such coffee products. Furthermore, all packaged beverages compete with coffee shops, now as convenient to find as convenience stores (most notably Starbucks), which offer freshly made impulse beverages at competitive prices.

Soft drinks are another area attempting to tap into the demand for alternative beverages. In fact, much of the growth previously stated as part of soft drinks can be considered as part of alternative beverages. For example, energy drinks are technically part of the soft drink area, although Red Bull truly started a new category. Red Bull energy drink grew 45% in both 2003 and 2004, reaching 30 million cases sold and making Red Bull the No. 7 soft drink maker in the U.S.[71] Energy drinks contain many of the stimulant herbs of functional teas, but with higher levels of concentration, including high levels of caffeine and sugars. This has been a hot area targeted to youths, particularly young men.

This whole category, led by Red Bull, blind-sided the big-three soft drink makers, which are still recovering. PepsiCo came out with SoBe Adrenaline Rush to compete in this area. Coca-Cola has been criticized for delaying its energy drink, Full Throttle, which was finally launched in 2005. Some frustrated Coke bottlers have resorted to selling energy drinks made by other companies to preserve shelf space in stores.[72] Before Coca-Cola launched Full Throttle, a tidal wave of new energy drinks emerged in 2004, from Monster Energy Drink (owned by natural fruit

[69] Ibid.
[70] "Coca-Cola's Healthy Alternative to Soda," Ball Corp., October 2003.
[71] *Beverage Digest*.
[72] "Behind Coke's CEO Travails: A Long Struggle Over Strategy," *The Wall Street Journal*, May 4, 2004.

juice and tea maker Hansen Natural) and independently owned Rockstar Energy Drink. This area is estimated to have grown as high as $2 billion in 2004.[73] This kind of growth leaves ample room for many more independent launches, and it seems as if a new energy drink is launched by the week.

A new soft drink with original flavors, Sprite Remix (Coca-Cola), reached 55 million cases, which routinely changes to offbeat flavors such as berry-clear, which attracts a young niche following. However, not all new soft drink flavors have staying power, for example, Vanilla Coke was down 21% in 2003 after a strong introductory year in 2002.[74] Also, 7up dnL (Cadbury Schweppes), with a distinctive green color and bold flavor, fell off the shelf in 2004 after scoring 10 million cases in 2003. So Cadbury Schweppes launched Mixed Berry 7up Plus to compete with Sprite Remix and Pepsi's Sierra Mist, in August 2004, which is fortified with calcium and vitamin C.

These new soft drink flavors are the result of the big-three frantically attempting to meet the demand for new and different flavors. But they need to look outside the standard soft drink model, into other types of alternative beverages such as PepsiCo's SoBe and Coca-Cola's Swerve. Young consumers need increasingly different flavored and packaged beverages to spark interest in this world of advertising-jaded youths. It seems the types of new beverages are limited by the imaginations of product development groups, and new categories are rising from all directions.

PepsiCo has been credited with moving into these new areas fairly quickly, but Coca-Cola has been criticized for moving slowly, such as their slow move into the energy drink market.[75] Coca-Cola has recently hired a new CEO, E. Neville Isdell, who promises to streamline the company and make it a faster organization. Some analysts point out that he is an old Coca-Cola executive, and they doubt that he has the ability to think outside the box and tap into the demands of youths.[76] But to his credit, Coca-Cola did finally move on Full Throttle after he took over, and they are experimenting with new drinks. For example, they are selling in Japan a grapefruit-flavored drink with caffeine called Body Style Water, claimed by Coca-Cola to help burn fat "through the aromatic power of grapefruit."[77]

The big-three need to stay on top of demand with customer studies and aggressive product development efforts. But similar to how large brewers are unable to completely dominate the beer market with microbrew competition, the big-three soft drink makers' ability to completely dominate the nonalcoholic beverage market in the same way as they do with soft drinks is diminished. They will always have advertising, distribution, and manufacturing economies of scale over small upstarts, but 10 Red Bull crazes might lurk around the corner, sending the big-three scrambling to meet demand and retain shelf space.

Low-Carb Transforms to Low-Cal

The low-carb trend has impacted all segments of the beverage industry. There is a growing concern among consumers about obesity, and low-carb diets have emerged as the latest weapon of choice to fight this problem. But as the low-carb-craze cools, consumers continue to demand low-calorie (low-cal) options for both food and beverages. Since most calories in most beverages tend to be carbohydrates, the same low-carb drinks are now

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[73] "Hansen Natural," *Business Week*, June 6, 2005.
[74] *Beverage Digest*.
[75] "Behind Coke's CEO Travails: A Long Struggle Over Strategy," *The Wall Street Journal*, May 4, 2004.
[76] "Coca-Cola Reaches Into Past for New Chief," *The New York Times*, May 5, 2004.
[77] "Fewer Carbs and Cals, More Ads," *The Wall Street Journal*, November 22, 2004.

being marketed as low-cal. Another marketing twist is the elimination of the word "diet" from many brand names, such as Coca-Cola renaming Diet Sprite to Sprite Zero, and PepsiCo renaming Diet Sierra Mist to Sierra Mist Free.

The latest soft drink offerings tap into this trend. Diet soft drinks have always been around, and have been selling well lately. But Coca-Cola and PepsiCo have been introducing diet versions of everything, from Sierra Mist to Vanilla Coke, and new twists on diet colas, such as Diet Coke with a twist of lemon and lime. From 1998 to 2004, Coke Classic and Pepsi were substantially down in volume sales, while Diet Coke and Diet Pepsi were significantly up. Now a new mid-calorie cola segment has emerged, with Pepsi Edge and Coca-Cola's C2. These new brands have a closer taste to the original colas, but with fewer calories using hybrid sweeteners. However, Pepsi Edge has been discontinued, and a similar fate is rumored for C2.

It appears that the big-three are focusing on offering more versions of their diet soft drinks. Many soft drink brands have switched to sucralose (the ingredient in Splenda) as a sweetener, such as Diet 7up and Diet Rite (both Cadbury Schweppes), but many brands are now offered with Splenda as an alternative to their original formula with aspartame (Nutra-sweet). For example, Coca-Cola now offers regular Diet Coke (with aspartame) and Diet Coke with Splenda. PepsiCo has reformulated an old brand called Pepsi One using Splenda, which is a one-calorie alternative to zero-calorie Diet Pepsi (with aspartame). Coca-Cola and Pepsi risk cannibalizing their flagship diet brands with these offerings. A further extension of a diet brand includes Coca-Cola Zero, which is zero-calorie and made with aspartame like regular Diet Coke, but formulated with a slightly different taste. Coca-Cola insists that this brand will not cannibalize sales of Diet Coke because it is targeted to young men, but this is yet to be seen. Whether these new diet brands are successful or not, their introduction underscores the willingness of the big-three to invest in low-cal brands.

Other nonalcoholic beverages are emerging as well. Coca-Cola's Swerve dairy-based drink has far fewer calories than its predecessor, Slap, because it uses a sucralose/high-frutose-corn-syrup (HFCS) sweetener blend. Naked offers low-carb fruit juice blends, and Snapple (Cadburry Schweppes) offers some low-carb/high protein soy-based versions of Snapple-a-Day, sweetened with a blend of sucralose and HFCS. Other low-carb fruit juices are likely to come. For example, Coca-Cola is experimenting with Frutonic in Australia, which is a lightly carbonated juice-water, with 12.5% juice, sweetened with a blend of neotame and sugar, and contains 66 calories in an 11-oz bottle.[78] The popularity of flavored water is partially due to demand for low-cal options.

The low-carb fad has hurt beer sales. AB introduced Michelob Ultra in late 2002, and sales increased five-fold in 2003, and continued to sell well in 2004. This exceedingly successful product appeals to young, affluent, and health conscious consumers, and has helped to win back many of the young drinkers straying to wine and spirits. Miller Lite and Coors Light responded with aggressive advertising, highlighting the low-carb attributes of their light beers. But Miller Lite, being lower in carbohydrates than Coors Light, won this battle and gained in sales at the expense of Coors Light. So Coors has introduced Aspen Edge, a low-carb beer that is being marketed as a high-premium product. AB has also reformulated Natural Light to have fewer calories, which is AB's sub-premium light beer that is on par with the quality of its Busch beer. Other major brewers have responded with extra low-calorie light beers as well, such as Interbrew introducing Labatt Sterling.

But spirits and wine makers have also responded to customer demands for low-cal products. Spirits are already low-carb, and usually zero in carbohydrates. However, even zero-carb alcoholic beverages have calories from the alcohol, a fact not mentioned in their low-carb advertising. Bacardi and Diageo have increased advertising, emphasizing the zero-carb qualities of their brands, and are offering suggested mixtures to maintain this quality,

[78] Ibid.

such as Bacardi rum and Diet Coke. This also allows them to share in advertising costs with soft drink makers such as Coca-Cola. Bacardi has introduced a low-cal flavored rum, Island Breeze, with 70% fewer calories than Absolut's flavored vodkas, sweetened with sucralose and containing a lower alcohol content.

Wine makers have entered the fray as well. The federal Alcohol and Tobacco Tax and Trade bureau recently said alcoholic beverage producers may list the calorie and carbohydrate content of their products on labels. Any listing must include fat and protein, and there must not be any implication that low-carb alcohol can play a healthy role in losing or maintaining weight. Most dry wines are already well below the seven-grams per serving threshold set for calling a beverage low-carb, and wine has no fat and a small trace of protein.[79]

Diageo has studied nutritional labeling, and are using labels hung around the top of bottles, known as bottle-neckers, which will be used on BV Coastal, Sterling Vinters Collection, and Century Cellars brands. Also using bottle-neckers is Sutter Home Family Vineyards. Its wines range from 122 calories and 2.7 grams of carbohydrates per 5-oz serving for its 2002 sauvignon blanc, to 119 calories and 4.1 grams of carbohydrates for its 2002 merlot. Sutter Home's famous white zinfandel has 8.3 grams of carbohydrates, just over the low-carb standard limit.[80]

Diageo and Sutter Home do not plan on changing their wines. But one company, Brown-Forman of Kentucky, maker of Jack Daniel's and Southern Comfort, is making a special low-carb wine brand. This company is a leading wine producer, owning California-based Fetzer Vineyards, among others. The new low-carb wines are named One.6 Chardonnay and One.9 Merlot, named after the number of carbohydrates in a 5-oz serving (i.e., 1.6 ounces and 1.9 ounces, respectively).[81] Pending the success of these brands, more wineries might try to reformulate their wines to produce super low-carb versions.

Summary

Evolving taste trends and globalization affect the beverages industry. Trading-up from beer to spirits and wine is a trend resulting from aging Baby Boomers. But surprisingly, young drinkers from Generation-Y are also trading-up, attracted to trendy ready-to-drink cocktails, and less expensive wines from a grape glut and intense international wine competition. Breweries, further hurt from the low-carb craze, have responded with clear malt-based drinks such as Zima (Coors), and low-carb beers such as Michelob Ultra (Anheuser-Busch). Craft beers and imported premium quality beers are also growing in popularity with older generations, resulting in larger brewers acquiring and developing high-premium brands. But microbrews will continue to be a thorn in the sides of large brewers.

Slow growth of alcoholic beverage consumption and stagnant population growth in developed countries has spurred consolidation and globalization of the alcoholic beverage segment. Large players have acquired international brands, formed joint ventures with local breweries, increased equity stakes in local breweries, and acquired local breweries. This consolidation helps to leverage advertising advantages, strengthen distribution and manufacturing economies of scale, and allows companies to expand into rapidly growing emerging markets in Asia, Latin America, and Eastern Europe.

Traditional nonalcoholic beverages are growing in some areas, but stagnant in most. Soft drinks are the kings of the nonalcoholic beverage industry in the U.S., with Americans consuming more volume of soft drinks per capita than

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[79] "Wine Companies Cut Carbs in the Carafe," CNN.com, May 20, 2004.
[80] Ibid.
[81] Ibid.

any other beverage. Growth in terms of volume increase is higher for soft drinks than any other beverage category, but has had sluggish growth in terms of percentage. Bottled water is the highest growing nonalcoholic beverage area in terms of percentage, and second highest in terms of volume growth. But bottled water has experienced little brand loyalty, pressuring pricing. Juice has had anemic growth, and ready-to-drink teas have had a resurgence from the proliferation of functional teas now offered by large companies.

Alternative beverages have been growing rapidly and threatening the big-three soft drink makers. Sports drinks are expanding. But energy drinks, led by Red Bull, took the beverage world by storm, and the big-three soft drink makers are still recovering. Functional teas and juices, infused with herbs, vitamins, and other additives have sprouted from almost nothing a decade ago. Enhanced waters offer value-added qualities that help to distinguish brands and encourage brand loyalty. Other alternative beverages, from originally flavored soft drinks to dairy-based drinks, are emerging all around, from both small independent firms to large soft drink makers. The low-carb craze has impacted the beverage industry as well, but it is transitioning into low-cal marketing. A new line of diet soft drinks has been introduced using multiple sweeteners, and alcoholic beverage makers are marketing low-cal attributes of their brands.

Business Initiatives and Risks

The beverages industry is a global industry driven by local trends and distribution networks. These trends and issues lead to potential initiatives to consider. Pursuing, and not pursuing, these initiatives come with risks for the companies in this industry.

Business initiatives for this industry run across three basic areas, including: strategy, marketing and sales, and product development. Strategy business initiatives relate to the consolidation and globalization trend occurring in this industry. Marketing and sales initiatives stress the importance of selling new products and selling all products to new developing markets. Product development business initiatives refer to streamlining product innovation processes and quickly introducing these new products to the marketplace.

Strategy

Globalization and consolidation is an ongoing trend in this industry, being driven by stagnant population growth and product saturation in developed countries. Acquisitions are a way to build economies of scale in manufacturing, distribution, and advertising. Many large brewers have been purchasing portfolios of internationally recognized brands, in part to have a global presence, and in part to meet emerging demand for premium-quality imports and craft beers made by microbrews. Purchasing breweries in developing countries is another form of global expansion, and taps into the growing populations, incomes, and popularity of beer in these countries. But tastes are often locally driven, distribution networks are often locally controlled, and many governments of developing countries prefer partnerships over direct ownership, so many brewers have entered into joint ventures and have taken on equity stakes in local breweries to retain local flavors and advantages.

Globalization and consolidation also apply to other areas of this industry. Many California wineries have acquired wineries and vineyards in Chile to diversify against poor grape harvests, and have acquired other California wineries to gain economies of scale and tap into the trendiest varietals. Spirits makers have consolidated globally since the late 1990s, and more consolidation is coming as Pernod Ricard and Fortune Brands agreed to acquire Allied Domecq. But most of these giants have grown to the point of raising antitrust concerns in the U.S. and the E.U. Acquisition opportunities might arise for flavored cocktail startups, which could catch on as a hot trend with young drinkers. Nonalcoholic beverage giants Coca-Cola and PepsiCo have gone global, and continue to do so, particularly expanding into developing countries. Acquisition opportunities exist in the alternative beverage arena, where new startups threaten the giants with new trendy drinks. In addition to developing these new drinks in-house with market research, nonalcoholic beverage giants need to keep an eye on emerging new brands and consider acquisitions when appropriate.

Brand loyalty is paramount in a saturated and mature industry such as the beverages industry, and it is most important to start brand loyalty young. Beer companies need to fight trading-up by youths to wine and flavored cocktails, and keep older generations from trading to microbrews over their own premium-quality brands. Wineries need to establish their brands as the “go-to” brand among a plethora of other international brands with younger generations. Spirits makers want to encourage the trade-up through flavored cocktails, but also link their brand to these cocktails to encourage transitioning to their straight spirits as this younger crowd ages. Nonalcoholic beverage giants need to establish their alternative beverage brands over the small start-up brands, which often catch on first as the trendy brand.

Components of Strategy business initiatives include:

- Pursue growth through acquisitions;
- Pursue growth through partnerships and alliances;
- Pursue growth through global expansion; and
- Establish brand awareness.

The following tables outline risks associated with these Strategy business initiatives.

Strategic	Operational
• New product/service fails in the market • Product obsolescence • Business initiative damages company's reputation • Business initiative dilutes company's brand • New distribution initiative results in channel conflicts • New geographic initiative leads to regulatory and political exposures • International initiative leads to expropriation and currency and convertibility risks • Failure of acquisitions, joint ventures, or alliances	• Inefficient operations render initiative unprofitable • Inadequate support cause products/services to fail • Inadequate production capacity to support initiative • Customer satisfaction suffers from poor quality • QC process breakdown results in poor quality • Breakdown in supply chain cause production/service irregularities • Liability assumed by contract • Loss arising from recall of defective products

Financial	Hazard
• Decline in credit rating • Currency fluctuations cause earnings volatility in home currency • Counter party default on settlements • Off-balance sheet liabilities and commitments larger than expected • Interest rate rise causes increased cost of capital • Shortages in key commodities • Highly leveraged capital structure causes burdensome interest payments or default	• Supply chain disrupted by fire, explosion or catastrophe • Trucks or autos damaged by collision or other hazard • Goods damaged in transit • Theft, robbery or fraud by third parties • Lawsuits arising from defective products • Lawsuits arising from contract disputes • Lawsuits by shareholders arising from errors or omissions of directors or officers

Marketing and Sales

In the saturated markets of developed countries, new products offer opportunities for growth. Alternative beverages sell at a high premium to traditional beverages, offering higher profit margins. Standard 15.2-oz. bottles of Odwalla blended fruit juices sell for as high as $4 in Manhattan, and are selling like hotcakes. Pom Wonderful pomegranate juice sells for $5 per 15.2-oz. bottle in Manhattan, and is also selling well. Low-calorie/low-carb beverages also offer growth. Diet soft drinks have been outpacing their standard counterparts for the past few years, and new diet versions, such as Diet Coke with Splenda, have been sprouting up. Breweries need to sell high-premium beers to compete with the growing popularity of microbrews.

With population growth stagnant in developed countries, developing countries offer long-term growth opportunities with exploding populations and income levels. Beer is becoming more popular in many regions. China is now the world's No. 1 consumer of beer, and even consumers in countries with strong wine traditions, such as Chile and Argentina, are increasingly drinking beer. Latin America has few regional beer brands, presenting opportunities for international brands to flourish. Eastern Europe already has a taste for beer, and seems poised for international brands as their incomes continue to rise. As incomes grow, more youths have access to discretionary spending, which has been driving growing sales of nonalcoholic beverages. Many new products also sell well in developing countries, particularly originally flavored soft drinks that appeal to local tastes. For example, Coca-Cola has launched Sprite Ice and Sprite On Fire in Singapore and Hong Kong.

Regardless of new products or markets, market share needs to be established through marketing since image is everything in the world of beverages. How hard is it to create a cola with the same quality as Coke? The answer is not very hard, and private-label companies do it every day. More important than manufacturing and distribution economies of scale, advertising is the cornerstone of establishing international brands. This has led to this industry

being among the top advertisers. All areas of the industry want to develop brand loyalty at a young age, which explains why so much advertising of this segment is directed to younger generations. New products, from low-carb beers, to flavored cocktails, to clear malt-based drinks, to alternative beverages, all need to establish themselves in the market and as the choice of consumers, or face loss of shelf space to the Red Bulls of the world. Only aggressive advertising can accomplish this feat, and leverage the distribution and manufacturing advantages of large companies.

Components of Marketing and Sales business initiatives include:

- Grow revenue through increased penetration of existing markets with new products and services;
- Grow revenue through penetration of new markets with existing products and services;
- Grow revenue through penetration of new markets with new products and services; and
- Grow market share through increased marketing efforts.

The following tables outline risks associated with these Marketing and Sales business initiatives.

Strategic	Operational
• New product/service fails in the market • Product obsolescence • Business initiative damages company's reputation • Business initiative dilutes company's brand • New geographic initiative leads to regulatory and political exposures • International initiative leads to expropriation and currency and convertibility risks	• Inefficient operations render initiative unprofitable • Inadequate support cause products/services to fail • Customer satisfaction suffers from poor quality • QC process breakdown results in poor quality • Loss arising from recall of defective products

Financial	Hazard
• Currency fluctuations cause earnings volatility in home currency • Counter party default on settlements • High demand elasticity of unit sales • Improper hedging techniques cause exposure to market volatility	• Trucks or autos damaged by collision or other hazard • Goods damaged in transit • Theft, robbery or fraud by third parties • Lawsuits arising from operation of motor vehicles • Lawsuits arising from contract disputes • Lawsuits arising from infringement of copyrights or patents

Product Development

Since new cutting-edge products are the only form of growth in developed countries, and these are the areas where industry giants are most exposed to competition, developing new products organically needs to be a top priority. Alternative beverages, craft beers, low-carb beers, hot new varietals of wine, flavored alcohol, and diet soft drinks are the areas of growth that large companies need to quickly tap. Coca-Cola's slow response to the new energy drink genre has hurt sales and lost shelf space to Red Bull. Their sluggish old-line organization introduced their energy drink, Full Throttle, just this year and many industry observers wonder if they will ever dominate this market already established by Red Bull at the grass-roots level.

The large companies need to streamline product development to allow for quick response to new trends, and more importantly to proactively anticipate new trends with aggressive market research. Slow responses to market trends can permanently harm market share and profit margins of new drinks. A risk is introducing disastrous new beverages that harm flagship brand images. A major risk is public health. Many new low-carb drinks, such as Swerve dairy-based drink by Coca-Cola, have hybrid sweeteners made with a combination of HFCS and sucralose and other artificial sweeteners. Most of these sweeteners have been shown to cause damage to livers and kidneys of laboratory rats, when consumed at high levels. Although many scientists claim that these substances are safe for humans to consume at lower levels, the long-term effects are not known, as these products have been rushed to the marketplace quickly in order to fulfill demand for low-carb alternatives. If problems emerge, lawsuits will follow, claiming negligence.

Once new products are established, large companies have manufacturing economies of scale advantages over small start-ups. Pushing the manufacturing efficiency envelope will help to gain price advantages over smaller companies, in combination with distribution economies of scale. This will help maintain market share over smaller alternative beverage brands and microbrews.

Components of Product Development business initiatives include:

- Accelerate pace of in-house product development;
- Streamline the product development process; and
- Increase manufacturing efficiency.

The following tables outline risks associated with these Product Development business initiatives.

Strategic	Operational
• New product/service fails in the market • Product obsolescence • Business initiative damages company's reputation • Business initiative dilutes company's brand	• Product development stalls from ineffective sourcing of resources • Inefficient operations render initiative unprofitable • Oversized overhead renders initiative unprofitable • Inadequate support cause products/services to fail • Inadequate production capacity to support initiative

Financial	Hazard
• Inadequate cash flow to support daily operations • Interest rate rise causes increased cost of capital • Large capital investments cause cash strain • Inadequate capital investments restrain future growth • Highly leveraged capital structure causes burdensome interest payments or default	• Workers injured during course of employment • Lawsuits arising from defective products • Lawsuits by shareholders arising from errors or omissions of directors or officers • Lawsuits arising from infringement of copyrights or patents