

Pepsi Next Case Study

In February 2012 the Pepsi Next product was launched into the US market. This case study provides students with an interesting insight into PepsiCo's new product process and some of the challenging decisions that they faced along the way.

Introduction to the Pepsi Next Case

Pepsi Next was launched by PepsiCo into the US market in February 2012 and has since been rolled out to various international markets (for instance, it was launched in Australia in September 2012).

The new product is described as a mid-calorie cola beverage, having a mix of sugar and artificial sweeteners, designed to deliver a full cola taste with reduced calories. While filling the market gap between full sugar and diet soft drinks, PepsiCo has indicated that its prime target market is lapsed cola drinkers (giving them a reason to return to the product category).

PepsiCo, which owns range of high-profile beverage brands in addition to its flagship brand Pepsi, appear to be highly committed to Pepsi Next providing it with strong launch and management support. In fact, according to PepsiCo themselves, this is their most significant product launch for several years.

About PepsiCo

PepsiCo is the second largest food and beverage company in the world, with revenues now in excess of \$60 billion. The corporation has 22 brands that achieve retail sales in excess of \$1 billion each. As a result of their brand diversification, around half of PepsiCo's revenue is generated from their food lines, such as Frito-Lay (snack food) and Quaker Oats.

In addition, they have progressively expanded internationally and now access over 80% of the world's population. Their international (non-US) markets account for almost 50% of their total revenues and they still see significant growth potential from these markets, on the basis that per capita consumption of snacks and beverages in other countries is well below US market levels.

As a result, PepsiCo has achieved solid growth in many international markets. While their US beverage sales fell by 2% in 2011, this has been more than offset by double-digit sales increases in Europe, Asia, the Middle East and Africa.

In terms of their overall strategic approach, PepsiCo (as highlighted on their website) see themselves as innovative and adaptive, as stated in the following website quote:

"Pepsi is constantly on the lookout for ways to ensure their consumers get the products they want, when they want them and where they want them."

PepsiCo Brand Strategy

In their Annual Report, PepsiCo has structured their brands around three related themes, as highlighted in the following table. This brand structure gives some insight into the role of their brands and how they see their brand portfolio developing in the future.

Emphasis of Brand	Key Brands
Fun-for-you	Pepsi, Mountain Dew, 7-Up, Lays, Doritos, Cheetos, Red Rock
Better-for-you	Pepsi Max, Diet Pepsi, Lays (oven baked), Quaker bars
Good-for-you	Tropicana, Quaker Oats, Gatorade, Nut Harvest
<i>(Note: The various terms, 'Fun-for-you' and so on are PepsiCo's terminology)</i>	

As you can see from PepsiCo's classification of their brands, it appears that the firm has the dual goals of supporting and leveraging its existing 'fun' brands, while moving towards a broader range of healthier offerings. While this second goal may appear to be mainly related to improving their corporate image, it does have commercial intent, as explained on the PepsiCo website: *"Because a healthier future for all people and our planet means a more successful future for PepsiCo."*

To help implement this corporate goal, across their various brands, PepsiCo has focused on providing a wider range of healthier choices, introducing more natural ingredients, reducing fat content, reducing the environmental impact of their packaging, and so on.

Recent Product Innovations

PepsiCo has a history of developing and launching a number of mid-calorie beverages and Pepsi Next is by no means their first attempt with this style of product. In addition to various Pepsi variations (described in the 'Before Pepsi Next' section below), they have had some recent success with reduced calorie versions within their Tropicana and Gatorade brands.

One very successful mid-calorie product initiative is Trop50, which was launched in 2010. Trop50, as implied by its name, is a version of Tropicana with 50% less sugar and calories. This new product was ranked as the 6th most successful new food/beverage product in its launch year with retail sales in excess of \$70 million. Its initial success has continued over the last two years, with the Trop50 product line now generating over \$150 million in sales.

And even more successful was Pepsi's launch of Gatorade G2 in 2007. (Note: Pepsi acquired the Gatorade brand with their purchase of the Quaker Company in 2001.) This low-calorie version of Gatorade was identified as the most successful new food/beverage product in 2008 in the US market, achieving sales over \$150 million in its first year.

Clearly, these fairly recent product successes with reduced calorie offerings under strong brands would have had the effect of buoying Pepsi's confidence regarding the viability of this style of product. Hence, they believed that it was the right time to revisit a reduced calorie Pepsi variation.

However, as some commentators have pointed out, it should be noted that their success (with Trop50 and G2) has occurred in their 'good-for-you' brand range, where consumers are already quite health-conscious and probably more responsive to healthier options. Therefore, whether this perceived benefit (of less sugar) will carry to 'fun-for-you' brands, like Pepsi, is less certain for the firm.

Before Pepsi Next

Perhaps surprisingly, Pepsi Next is PepsiCo's fifth attempt at a mid-calorie beverage. In the 1970's they introduced Pepsi Light, which was lemon-flavored and contained 70 calories (as opposed to a normal Pepsi can at 150 calories). *(Not to be confused with the current Pepsi Light brand marketed in various countries, which is a version of Diet Pepsi.)*

Then in the late 1980's the firm introduced Jake's Diet Cola, which came in at a mere 15 calories, but did not leverage the Pepsi brand name. At the time, Pepsi stated that the beverage had the potential to "revolutionize" the diet segment of the cola market. Prior to launch, Jake's was extensively taste-tested against Diet Coke and the firm had strong hopes for its success.

According to one of their vice presidents at the time (Edward E. Jenkins), *"Jake's represents a new taste concept in diet beverages and will provide consumers in the booming diet soft drink category with a better-tasting, low-calorie cola"*.

In the mid-1990's, they then introduced Pepsi XL, another 70 calorie formula. In their promotions, they indicated that X stood for 'excellent taste' and the L stood for 'less sugar'. According to reports at the time, Pepsi XL was a year in development at a cost of \$1.5 million and was supported by an \$8 million advertising budget.

More recently, in 2004, PepsiCo released a 70-calorie beverage branded as Pepsi Edge. Around the same time, Coca-Cola brought out a similar product under the brand Coca-Cola C2. Coke supported C2 quite aggressively, with an estimated launch promotional budget of somewhere around \$40 million, making it their most significant launch since Diet Coke. Both of these brands only lasted around 18 months or so in the market before being withdrawn.

About the Soft Drink (Soda) Market

The US soft drink market generates over \$70 billion in sales. Volumes (units) have weakened slightly since 2005, indicating that the market is in late maturity-early decline stage of the product life cycle. Retail dollar sales have been supported somewhat by price increases.

One of the biggest impacts on soft drink consumption has come from bottled water, which now accounts for over 10% of beverage consumption. This is up from just 2% in 2000. And the soft drink market has also been slightly challenged by sports drinks and energy drinks that have seen a minor increase in market share.

The trend towards diet soft drinks continues, with these offerings now representing 30% of the carbonated soft drink (CSD) market, up from 25% just 10 years ago. Overall, these movements indicate changing tastes of consumers as a result of a stronger health focus.

One of the brands most impacted by these market changes has been the flagship Pepsi brand. In the most recent market share figures available, Pepsi now has less than 10% share of the US CSD market (which ranks the brand 3rd behind Coke and Diet Coke). While still well positioned, keep in mind that they were sitting at over 13% market share ahead of Diet Coke 10 years ago, at a time when the CSD market was still growing at 3% per year.

Their Diet Pepsi product enjoys a solid 5% market share. That product, along with Pepsi's other soft drink offerings (Mountain Dew in particular), gives Pepsi an almost 30% share of the US CSD market, behind Coca-Cola at 42% (with Coke at 17% and Diet Coke at 10%) and ahead of Dr Pepper Snapple at 17%.

Competitor Offerings

Pepsi isn't the only player seeking to tap into the perceived demand for reduced sugar beverages. Dr Pepper Snapple (who has two products in the top 10 in the US CSD market) has also introduced a low-sugar offering. Their new product, Dr Pepper Ten (with 10 calories), is squeezed between their normal Dr Pepper and their Diet Dr Pepper, much in the same way the Pepsi Next product. Reportedly, Dr Pepper Snapple is pleased with the performance of this new product to date.

Independent to the Pepsi Next offering, Coca-Cola is currently (mid-late 2012) in the process of test marketing (in four American cities) mid-calorie versions of their Fanta and Sprite brands. Carrying the sub-brand 'Select' (to make Fanta Select) the concept is quite similar to Pepsi Next in that it uses a mix of sugar and artificial sweeteners to cut the calorie count by half.

Obviously if these tests are successful and these products are fully rolled-out to the market as a standard product, it appears that there could be a third sub-category of soft drinks; traditional, diet, and now mid-calorie beverages. It would then be interesting to see how and if this sub-category develops, particularly with more offerings and overall promotional support. But on the other hand, it might be possible that Coke might be test marketing the mid-calorie Sprite and Fanta options as a form of market research only.

Impact of Substitute Products

Why it may seem strange that a highly successful company like PepsiCo would frequently come back to a product concept that they had struggled with a number of times, it appears that one of the key drivers has been the slight decline in the US carbonated soft drink (CSD) market in recent years.

It is estimated that the cola category of the CSD market is reducing by around 90 million cases a year. These consumer purchases have tended to shift to other beverage solutions, such as water, energy drinks and juices.

One of the underlying factors driving this change in behavior has been identified as the preference that some consumers have to reduce sugar. Therefore, PepsiCo see the new Pepsi Next product as a viable low-sugar alternative to traditional soft drinks, and a product that could tap into consumer's emerging dietary needs and to generate sales from outside the traditional cola market and to win back lost cola consumers.

Therefore, PepsiCo is more confident in the success of Pepsi Next (despite numerous withdrawn similar products) because they believe that the market is now more ready for this type of product, that is, Pepsi Next is the *"right product at the right time"*.

Pepsi Next: Strategy, Development and Launch

As stated above, a key goal of the Pepsi Next offering is to try and win back cola drinkers lost to other beverages. Pepsi's research suggests that sugar and carbohydrates is an issue for some consumers, but a reasonable proportion of these consumers have not warmed to the taste of diet colas. Therefore, these 'sugar-avoiders' have migrated to non-cola beverages as a better product solution for their needs and preferences.

Another important goal, as Pepsi continues to battle Coca-Cola's range of brands for market share in the CSD market, is to keep their flagship brand fresh, exciting, energized and innovative. For instance, Coke Zero was a very successful new product (a sub-brand under the Coke family brand), which also had the impact of adding excitement to the Coca-Cola product.

This was achieved primarily by Coke Zero's main communication theme that Coke Zero tasted just like Coke. The firm used a variety of promotional tools, including a series of humorous YouTube videos with pretend (and somewhat inept) Coke brand managers who were intent on taking legal action against Coke Zero.

Another important aspect to keep in mind for Pepsi Next and its likely financial viability is the overall size of the CSD market. In the USA alone, sales in this market are in excess of \$70 billion. And although the market is slightly falling (being in the very early stage of decline), the market is only reducing by about 1% per year, which means that it will remain a very large and profitable market for a long time to come.

With this in mind, even a fraction of market share in the CSD market is significant. For instance, Coke Zero (a product launched in 2005) has a market share just over 1% in the US, which equates to retail sales over \$700 million per annum in the US alone - and based on Pepsi's corporate figures (where almost 50% of their revenue is achieved in international markets), they probably achieve at least equal sales revenues internationally. This should deliver good gross margins, as the product would be produced, distributed and marketed using existing infrastructure and facilities.

Of course, while Pepsi has indicated that they are taking a long-term view of the market and this product, these statements may or may not be true. In these types of markets (fun food and drinks), variety and new flavors are often used as an effective short-term tactic. For example, chocolate manufacturer Cadbury frequently brings out new products for a limited time only. It is also a common tactic in the fast-food industry.

This variety approach will help boost short-term sales, energize the main brand, generate media attention, disrupt competitor activities, give freshness to the firm's promotional messages, and hopefully engage consumers.

Market Gap

Pepsi Next is obviously designed to fill the gap between normal sugar cola drinks and diet colas, trying to appeal to consumers that may sometimes prefer lower-calorie drinks but are concerned with the taste or the social image of diet drinks and vice versa.

The clear challenge here is whether this mid-calorie 'compromise' offering provides a strong benefit for existing beverage consumers. That is, will regular consumers of diet colas be tempted to switch, and will consumers of regular colas be happy enough with the taste of Pepsi Next to take it up? That challenge is obviously one reason that Pepsi has included a heavy free sample aspect in their promotional mix.

Therefore, there appears to be two main risks associated with targeting this market gap. The first is whether the demand from consumers will be large enough to make the segment financially viable. And the second is virtually the opposite concern; if the product becomes quite successful, will it cannibalize both the Pepsi and the diet Pepsi offerings.

While the second 'risk' could have the upside of providing a competitive barrier (without necessarily increasing overall sales), which is generally beneficial for PepsiCo in the longer-term, it does not really advantage Pepsi's retailer partners who may not benefit to any real extent from this broader product line offering.

However, another way to look at this market gap is to not see it as a gap at all, as suggested by PepsiCo. That is, to consider the product to be competing against substitute products outside the existing cola market. Therefore, this offering may appeal to consumers who don't see a benefit in any existing cola drinks, diet or otherwise.

Market Testing

Given PepsiCo's experience with mid-calorie beverages (with both Pepsi and other key brands), the firm would have a wealth of knowledge and data surrounding this market need and the resultant behavior of consumers and distribution channels. Despite this background, Pepsi Next still went through the firm's standard approach of taste-testing and market tests. For instance, in 2011, they conducted blind taste-tests with some of their bottlers.

As would be assumed from the launch support for the new product, the results from the consumer taste-tests were very positive. According to Angelique Krembs, VP-marketing for the Pepsi trademark, *"When people try the product, they're just really impressed."*

In addition to taste-tests, Pepsi Next was test marketed in Iowa and Wisconsin. In these tests, it was determined that a broad variety of consumers (in demographic terms) were willing to try Pepsi Next. However, the research was also able to identify that the consumers tended to be regular Pepsi drinkers who saw the benefit of reduced sugar but have not been keen on existing diet soda options.

According to released results of the test markets, Pepsi Next exceeded their internal targets for trial, repeat business and incremental business. While there is a significant risk that this type of product had the potential to cannibalize Pepsi, Diet Pepsi and Pepsi Max, the firm believes (based upon the test market results) that Pepsi Next will attract new consumers and energize their entire Pepsi brand family.

Ingredients

In order to achieve a taste similar to a standard cola beverage with the sugar content, Pepsi Next uses some sugar along with a mix of three artificial sweeteners and high fructose corn syrup. However, the Pepsi Next product introduced in Australia has a slightly different formulation, as it included a natural sweetener called Stevia. Apparently, Stevia was not part of the US beverage design as it can have a bitter after-taste.

Also, Coca-Cola's Sprite/Fanta mid-calorie offerings (currently being test marketed) will utilize a different mix of sweeteners, with the major players each trying to get that right combination of taste with reduced sugar content.

Brand Name Selection

The brand name selection for Pepsi Next is quite interesting as it has a significant forward-looking emphasis. As many people are aware, for many years Pepsi has used the tagline, *"The choice of a new generation"*. This tagline was designed to reposition Coca-Cola as an old-fashioned drink, mainly enjoyed by older people.

With the use of the word 'Next', Pepsi are highlighting that this refers to the 'next generation' of soda drinkers. And, as discussed above, Pepsi believes that health and sugar-reduction is a long-term trend that will become more prominent.

The other aspect about the brand name selection to note is that the firm decided to use the family brand (Pepsi) and create a new sub-brand (individual) – creating Pepsi Next. Of course, both Coke and Pepsi have had a long tradition of successfully establishing new brands, so it is always of interest when they decide to leverage their flagship brands.

Obviously, even though Coke and Pepsi both have enormous brand equity throughout the world, there is still a limit to the range of offerings that each firm would want under these brands. That is, they would want to continue to protect their flagship brands and ensure that they are clearly understood by consumers and ensure that too many products do not confuse their positioning.

Launch of Pepsi Next

The new product's promotion was based around the tagline *"Drink it to believe it"*. It is a relatively major launch, which is reflective of their desire to finally achieve success with this style of product and to ensure that the new product is well received by the market in order to further enhance the brand equity of Pepsi itself.

In terms of its promotional mix, Pepsi Next was promoted via TV advertising, digital marketing, direct mail, heavy free trials and in-store point-of-promotion.

The main TV commercial, which was also tested in the test markets, shows a couple becoming very excited about the innovativeness of Pepsi Next. In the background, unnoticed by the parents, the baby does a number of highly remarkable stunts. The main message of the TVC is that Pepsi Next is so amazing and innovative that nothing else seems to stand out.

Obviously, in today's environment, a social media campaign via Facebook as well as YouTube formed a key platform in their overall promotional mix. A key aspect of the YouTube campaign (billed as the world's first virtual taste-test) is the potential for consumers own taste-test videos to be parodied by a range of celebrities. This approach not only increases the profile of the campaign, but also the level of the consumer's engagement with the new brand.

Although the actual promotional budget for Pepsi Next has not been disclosed by the firm, PepsiCo has announced that they have increased their overall marketing budget (across all their beverage brands) from \$500 million to \$600 million in 2012.

Pepsi Next was also promoted via leveraging the firm's relationships with retailers and tapping into retailers' loyalty card programs. Access to this immense loyalty database has enabled Pepsi to identify consumers that have reduced their cola consumption over time, which is stated as the target market for Pepsi Next.

Free trials/samples have also been heavily utilized. For example, in the USA, free samples of Pepsi Next were offered across 800 Walmart stores as well as in 40 cities via events. In Australia, Pepsi is using several 'challenge vans' which will be set up in around 300 outdoor locations during the Australian summer. The main focus of the 'challenge vans' is for consumers to blind taste-test Pepsi Next against normal sugar cola (presumably Coke, but not explicitly stated).

Therefore, it appears that a key goal of their promotional approach is to generate initial trials, with the hope of generating a reasonable proportion of repeat customers.

It is important to note that despite a significant upfront promotional investment, Pepsi are planning to support and monitor Pepsi Next over the long-term. Again, according to Angelique Krembs, VP-marketing for the Pepsi trademark, *"I believe a new product is a new product for two years. We'll be watching closely, and we'll correct what needs to be corrected. We're taking a long-term view of support for this brand."*

Product-line Extensions

Although Pepsi Next was only launched into the US market in February 2012, by July 2012 two-line extensions were introduced into the market. The two variations are both fruit-flavored colas (Cherry Vanilla and Paradise Mango). Upon their launch (which coincided with summer), PepsiCo indicated that both flavors would only be available for a limited time only. Like the standard Pepsi Next product, the new flavors contained 60 calories, but both carry less caffeine.

To help explain the rationale for these line extensions Angelique Krembs stated, *"Earlier this spring, Pepsi Next launched to national fanfare, turning cola lovers into believers by delivering on real cola taste with 60 percent less sugar than Pepsi-Cola and for many, it was love at first sip. We're continuing the momentum by infusing real cola taste with unique fruit flavor blends, and giving cola lovers two more reasons to 'drink it to believe it.'"*

Pepsi Next Results

Indra Nooyi, the Chairman and CEO of PepsiCo, has publicly stated that the new product is *"off to a good start... (and it is) consistent with our objective of bringing back lapsed cola drinkers. While it's very early, the results are ahead of launch expectations"*. This comment further reinforces Pepsi's goal of sourcing demand from outside the traditional consumer base and regard their competitive set for this product to be non-cola beverages, rather than Coke.

But Nooyi did temper her above comments with, *"It's too early to call this brand and say it's a gigantic success. But what is surprising to us is that a few weeks after the launch, it's almost one share point, which has not happened in a long time for any new product launch"*.

While an initial market share of almost 1% represents a significant amount of revenue, it should be noted there is a major difference between initial trial sales volumes and ongoing repeat sales volumes – particularly for a well-executed national launch under the banner of a major brand.

Weakening Sales?

In terms of sales data, it has reported that Pepsi NEXT's volume market share has since fallen to 0.6%, down from 1.0%. Additionally, a survey of the channel convenience stores found that Pepsi Next has achieved very strong distribution (with 94 % convenience store penetration), but many stated that the brand is generating weak repeat sales.

It could also be argued that the early line extensions were designed to help strengthen and energize the brand, as it is struggling with its repeat sales. Perhaps the initial strong sales results were somewhat propped up by the novelty taste, the extensive free sampling and significant initial discounting.

Regardless, the firm has indicated that they remain very confident in the future of Pepsi Next, particularly given their view of the future market for sugary beverages. PepsiCo Americas Beverages CEO Al Carey has stated that they continue to feel "very good" about Pepsi Next and that the new brand was tracking ahead of its targeted 25 million cases in first year sales, primarily because it was re-winning lost Pepsi drinks – either back to Pepsi Next or Pepsi itself.

Student Discussion Questions

1. Outline the new product process for Pepsi Next. How consistent is their approach to the process described in marketing textbooks?
2. PepsiCo has been quite persistent with pursuing mid-calories beverage products - why do you think this is the case? Do you agree with their decision to introduce Pepsi Next? Why/why not?
3. How is the performance and market acceptance of Pepsi Next likely to impact the overall brand equity of Pepsi? Should PepsiCo have launched this product under a new brand instead?
4. The launch strategy seemed to heavily focus on generating trials. Why was this important? How else could the launch program have been structured?