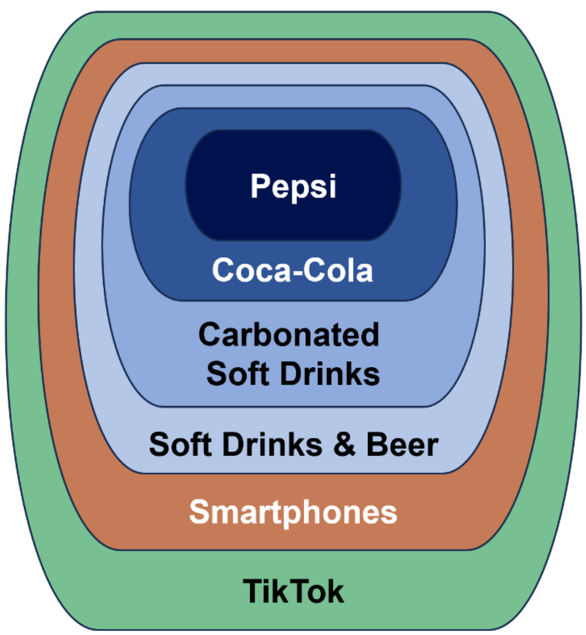
WHAT IS A OUR COMPETITIVE SET? THE PEPSI EXAMPLE

Who do we compete with? We use the Pepsi brand to expand the definition from the obvious to the sublime. We divide the reasoning into a qualitative example and a mathematical theory.

The competitive set are the brands and companies we compete with. The set can reach far outside the immediate competition. This reach explains why categories decline over decades, like colas have done in the U.S. for decades (per capita consumption).

COMPETITIVE SET THEORY



$$\epsilon_{P1,1} + \epsilon_{P1,2} + \epsilon_{P1,3} + \cdots + \epsilon_{P1,n} + \epsilon_{I1} = 0$$

Own-price elasticity **<0**; Cross-price elasticities **>0**; Income elasticity **>0**

Therefore: if $\epsilon_{P1,1} + \epsilon_{I1} \neq 0$ we have not defined our competitive set correctly

Note: There are rare cases when the elasticities flip sign
Source: Tellusant thought

REASONING

❶ In the 1980s, Pepsi was engaged in the cola war with Coca-Cola in the U.S. It built its competitive position by making Pepsi aspirational for a young generation—the Pepsi Generation. Michael Jackson was central to this with this video: https://www.youtube.com/watch?v=po0jY4WvCI

❷ But Pepsi competes with more than Coca-Cola. It also interacts with other carbonated soft drinks like Sprite, Dr Pepper, and many more.

❸ Beyond CSDs, Pepsi competes with the broader soft drink set including juices, energy drinks, etc. It also competes with beer.

So far, obvious competitors.

❹ Remember how Pepsi and Coca-Cola were aspirational in the 1980s. There is little of that left in the U.S. today: you go to the supermarket and see 2 liter PET bottles; you go to a bar and get the beverage from a soda siphon. Today, many young people express aspiration through the smartphone they use. Because of higher income levels, aspiration has moved to a higher level. The competition is the smartphone.

❺ Or maybe only in part. Aspiration does not have to cost money. Making TikTok videos is today the highest level of aspiration and self-expression.

Thus, Pepsi's competitive set is expanding and ever encroaching on its domain.

MATHEMATICS

How do we know what the competitive set truly is. With difficulty. One helpful tool is Euler's homogeneous function theorem as applied in the Marshallian demand function.

This states that the sum of own price elasticity, all cross-price elasticities, and the income elasticity must equal zero. If we have covered the complete competitive set, this must be true. There are no cross-elasticity interactions outside our set.

Therefore, **if the own-price elasticity + income elasticity ≠ 0, we have missed some of the competition when defining our set**.

This is violated all the time. Companies tend to view their competition too narrowly. This is fine for tactical decisions like price-promo choices, but it is a major flaw in their strategies.

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This illustrates how you go from one fundamental analysis to massive implications.