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Coca-Cola in 2011: In Search of a New Model

Muhtar Kent, CEO of The Coca-Cola Company (Coke), breathed a sigh of relief. On October 3, 2010, he had finally closed the largest acquisition in the company's history: the $12 billion purchase of the North American operations of Coca-Cola Enterprises (CCE), Coke's largest franchised bottler. With the acquisition, Coke now controlled approximately 90% of its total North American volume, reversing its 1986 decision to separate itself from the bottling business.

For most of the last 125 years, Coke had manufactured concentrate and focused on driving demand and customer loyalty through heavy investments in brand marketing. The capital-intensive job of producing drinks, running trucks, and supervising distributors mainly resided with Coke's franchise bottlers. This business model had served the company well. Coke had become the world's largest soft-drink company, selling 1.7 billion servings of beverages every day to consumers in over 200 countries through more than 300 bottling partners. Coke was considered the most recognized, powerful brand in the world, valued at $70 billion in 2010.[1]

At the same time, Coke faced several challenges in the U.S. market, which prompted Kent to re-think the strategy. Selling sodas was no longer enough to quench American consumers' thirst and taste preferences. Carbonated soft drinks, which represented 76% of Coke's global volume, had lost some of their fizz amid anti-obesity campaigns and active lifestyle movements. Consumers sought alternative non-carbonated beverages, ranging from teas to coconut water, which involved different production and distribution methods from Coke's traditional system. Broader issues surfaced as well, including environmental concerns about packaging and rising commodity costs (see **Exhibit 1** for the challenges facing Coca-Cola). Digital media and social networks were also changing the marketing landscape: Coke could no longer rely on traditional media alone to drive brand preference.

Despite the challenges, Kent was confident that Coke could achieve its "2020 vision" to double the Coca-Cola system's revenues by the year 2020 (see **Exhibit 2** for a summary of the company's vision for 2020).[2] Buying CCE was an important component for realizing this vision. Kent claimed, "I think there is no better system in the world than the franchise model, but it has to evolve."[3] Yet there were many ways the franchise system could evolve. For example, should Coke keep the bottling business and control the whole value chain? Or, should Coke "fix" CCE and refranchise the bottling business, as it had done in the past? Or perhaps Coke should keep manufacturing and refranchise distribution, similar to what the beer industry did? For one of the most successful companies in the world over the last century, Kent's answers to these questions had the potential to redefine Coke's business model for the next 100 years.

Professor David B. Yoffie and Research Associate Renee Kim prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

History

Coca-Cola was first invented in 1886 by John Pemberton, a pharmacist based in Atlanta, Georgia.[4] He combined syrup with carbonated water and sold the drink at a soda fountain in a local drugstore. Five years later, Pemberton sold the concoction to Asa Candler, an Atlanta businessman. Candler aggressively marketed the soda and made Coca-Cola available in every state by 1895. He kept the formula a secret and locked it up in a bank vault, creating widespread speculation about the ingredients. Convinced that Coca-Cola's future was in fountain sales, Candler sold the bottling right to two Chattanooga lawyers for $1 in 1899. According to Candler, "we have neither the money, nor brains, nor time to embark in the bottling business."[5] Contrary to Candler's belief, the bottling business flourished. Over the next two decades, the Chattanooga team created a regional network of more than 1,000 bottlers, which were usually locally owned and operated.

In 1916, Candler sold Coke to a group of investors, led by Ernest Woodruff, who took the company public that year. His son, 33-year-old Robert Woodruff, became president four years later, marking the beginning of a leadership that would span over six decades. Woodruff introduced several hallmark innovations to put Coke within an "arm's width of desire," such as the six-bottle carton, open-top cooler, automatic fountain dispenser, and vending machine. Coke became synonymous with famous advertising slogans such as the "Pause that refreshes" and "It's the real thing." The company's product portfolio expanded by buying Minute Maid (1960) and launching new, flavored sodas, Fanta and Sprite.

Woodruff was also credited with turning Coca-Cola into an international phenomenon. During World War II, he promised that "every man in uniform gets a bottle of Coca-Cola for five cents wherever he is and whatever it costs the company." Coke received exemptions from wartime sugar rationing for beverages that it sold to the military or to retailers that served soldiers. Sixty-four overseas bottling plants were set up during the war throughout Europe and Asia, not only serving American soldiers, but also giving locals their first exposure to Coke. Although Woodruff officially retired in 1955, in effect, he continued to serve as Coke's patriarch until his death in 1985. He influenced major corporate decisions, which included handpicking Roberto Goizueta to become the CEO in 1981, overruling retiring CEO J. Paul Austin's own choice for his successor.

Goizueta Era (1981–1997)

Goizueta, a chemical engineer from Cuba, took over Coke amid an intense cola war. PepsiCo (Pepsi) had been chipping away Coke's lead in the U.S. market since the mid-1970s through a successful taste-test challenge that promoted Pepsi as part of a young "Pepsi Generation." In the battle for more market share, both companies pushed for aggressive price promotions; reportedly as much as 50% of their combined food-store volume was sold at a discount, eroding margins. Consumers, accustomed to such discounts, frequently switched back and forth between brands, buying whatever was on sale. Goizueta fought back by stepping up Coke's advertising spending. Most of Coke's non-soda business was sold off, including wine and shrimp farming. Sugar was replaced with high fructose corn syrup, which cost about 40% less than natural sugar.

The company introduced 11 new products during the 1980s, coupled with a greater variety of packaging. The biggest hit was the launch of Diet Coke in 1982. Initially, the idea of extending the trademark Coke name to another product was considered "heresy" by several company insiders and bottlers. But Goizueta pushed through and debuted Diet Coke with the most expensive marketing budget ($100 million in the first year) in the soft-drink industry's history to date. By the end of 1983, Diet Coke had become the best-selling diet soft drink.

Then, in hopes of creating another hit like Diet Coke, Goizueta decided to change the 99-year-old Coke formula and replace it with New Coke in April 1985. New Coke not only fizzled, but also found itself fighting consumers' emotional attachment to the old Coke. Goizueta admitted, "We knew some people were going to be unhappy, but we could never have predicted the depth of their unhappiness."[6] Three months later, Goizueta returned the original formula under the brand name Classic Coke.[7] The comeback drove Coke's stock price to a 12-year high.

Abroad, Coke continued to expand its presence, most notably across Asia to Eastern Europe. After the fall of the Berlin Wall in 1989, Coke quickly invested $1.5 billion into the region to challenge Pepsi's early foothold. Coke built new networks of bottlers and distribution routes from the bottom up, while Pepsi continued to rely on its existing state-owned bottlers and network. By 1992, Coke's market share in several Eastern European markets, including Hungary, Poland, and Czechoslovakia, had nearly doubled from the previous year.[8]

The Lost Decade

In 1997, Goizueta's leadership came to an abrupt end with his unexpected death from lung cancer. "He was great and he was brilliant," recalled John Farrell, vice president of strategic planning.[9] Coke's market value had risen from $4 billion to $147 billion, the share price had skyrocketed over 5,000%, and Coke had become one of the most highly valued brands in the world.

Yet Coke's leadership struggled for the next decade, starting with Goizueta's successor, Douglas Ivester (see **Exhibit 3a** for Coco-Cola's share price performance after Goizueta's death). The 1997 Asian financial crisis crimped profits for the company that generated about two-thirds of its sales from overseas. Another crisis surfaced in Belgium (1999) over alleged contamination fears, forcing the company to conduct the largest recall in its history. Ivester was criticized for being slow to react, dealing a severe blow to Coke's brand image.

The board chose to replace Ivester with Douglas Daft (2000–2004). He tried to cut costs and laid off over 6,000 employees during the early 2000s, Coke's biggest job reduction in history. Legal problems involving a racial discrimination suit and a questionable marketing test involving Burger King cost Coke over $200 million in settlements. The company came under investigation by U.S. government authorities over claims that Coke inflated profits by shipping excessive amounts of syrup to its overseas bottlers, a practice known as "channel stuffing." Abroad, more contamination scares surfaced in India and Europe, tainting Coke's already troubled image.

Several big opportunities to expand Coke's business went astray as well. In 2000, Daft tried to buy Quaker Oats for $16 billion, but the deal was killed at the last minute by several Coke directors who thought the price tag was too high.[10] Pepsi bought Quaker Oats instead, gaining ownership of Gatorade, the leading brand in the fast-growing category of sports drinks. In 2001, after two years of negotiations, Coke gave up on efforts to buy South Beach Beverage Co. (SoBe), only to watch Pepsi acquire it. Around the same time, Coke called off a planned $4 billion juice and chips joint venture with Procter & Gamble. "It was just one thing after another," recalled Clyde Tuggle, Coke's senior vice president for global public affairs and communications.[11] "We didn't have the right answers, so we kept stumbling, trying to figure out how to get out of our financial, structural, and reputation mess."

E. Neville Isdell replaced Daft in April 2004, Coke's third CEO in seven years. He was a 35-year Coke veteran who had been called back from his retirement. "Neville was a world-class diplomat, and this company had been successful when it worked with this kind of a leader," recalled Farrell. Isdell returned to find a demoralized company struggling with declining sales and ineffective marketing. He brought some 150 senior managers from across the globe together for the first time in years, and they collaborated to create a "manifesto for growth," a new 10-year strategic plan. "We needed to pull together and motivate our people again and that's exactly what Neville did," stated Farrell. The plan called for the revival of Coke's core sparkling brands (Coca-Cola, Fanta, and Sprite). Isdell subsequently committed $400 million for marketing to strengthen their brand power.[12] He also expanded Coke's portfolio to include non-sparkling drinks such as enhanced water and teas.

At the same time, Isdell tried to bring back several senior managers who had left Coke during its period of turmoil, including Muhtar Kent. As the son of a Turkish diplomat, Kent spoke many languages and had spent much of his career with Coke overseas. He was known to be personable yet relentless, driven by a genuine passion for the business. When running a brewery in Istanbul, Kent was frequently spotted talking to shoppers in supermarkets and customers in bars, offering free bottles of his own brewery's brand in hope of convincing them to switch. He returned to Coke in 2005 to spearhead the company's international business; a year later, global sales increased 6%, the best gain in six years.[13] In 2008, Kent took over the CEO position from Isdell, who claimed that he had only wanted to stay for a few years. Isdell enthusiastically described Kent: "He's one of the world's best networkers, and that's what you need in the business that we're in."[14] Moving forward, analysts noted that the biggest challenge for Kent was to figure out how to restore growth in North America, the single largest market for non-alcoholic, ready-to-drink (NARTD) beverages, amid fizzling soda sales (see **Exhibits 3b, 4,** and **5** share price performance and selected financials).

The Soft Drink Industry

Sparkling beverages were a $74 billion retail market in the United States that had thrived under intense competition between Coke and Pepsi for over a century.[15] Consumption had steadily increased throughout the years, thanks to attractive prices and widespread availability, peaking at 864 eight-ounce servings per person per year in 1998. Although consumption had declined amid a wider variety of alternative beverages, the average U.S. consumer still drank 708 servings of sodas a year in 2010 (see **Exhibits 6a** and **6b** for consumption numbers for various beverages). Megabrands—a brand or trademark with annual volumes exceeding 100 million 192-ounce cases—dominated with 66% of the sparkling beverages' market share, led by Coke brands (see **Exhibit 7** for the top-10 sparkling brands). The soft-drink business model involved four primary participants: concentrate producers like Coke itself, bottlers, retailers, and suppliers.

Concentrate Producers

Concentrate producers blended common ingredients and flavors, and shipped the mixture in containers to bottlers. The manufacturing process itself involved relatively little investment in machinery, overhead, or labor. A typical beverage-concentrate manufacturing plant could cost about $50–$100 million to build and could supply several countries. As of 2010, Coke operated approximately 30 principal beverage-concentrate plants for its entire market of over 200 countries.

Marketing, market research, and maintaining bottler relations were critical elements for concentrate owners to build powerful, global brands. In 2010 alone, Coke spent $2.9 billion in advertising expenses.[16] "The value of this business is in the brand," Kent insisted. "It's much more holistic than just the drink." Bottlers' cooperation played a major role in jointly implementing marketing programs created by Coke. To help "influence" bottlers, Coke devoted about $5 billion in 2010 for its bottlers and resellers worldwide to engage in promotional or marketing programs.[17] It pursued customer development agreements (CDAs), whereby bottlers used funds provided by Coke to secure shelf space with national retailers like Walmart and supermarket chains. In addition, concentrate owners negotiated directly with their bottlers' major suppliers to guarantee low prices and reliable supply for key ingredients.

Bottlers

Bottlers bought the concentrate or syrup, added carbonated water and sweeteners, and then packaged the drinks into bottles or cans. Each beverage ran on a specialized, high-speed production line that was usually not interchangeable between different products and package sizes. The cost of a large plant with multiple lines and automated warehousing could reach hundreds of millions of dollars. As such, the bottling process for sparkling drinks, also known as "cold-filled," was productive and most profitable with high-volume, high-demand sodas. Bottlers were also responsible for selling and delivering drinks to customers. CCE, Coke's largest bottler, operated nearly 350 distribution outlets and around 55,000 vehicles in 2009.[18] Through direct store delivery (DSD), bottlers themselves stocked the shelves, kept track of inventory, and set up displays in retail outlets, rather than delivering the beverages to a retailer's warehouse.

Under this setup, a typical bottler's cost of sales exceeded half of its total sales. Concentrate and sweeteners represented the biggest expense, followed by packaging, labor, and overhead. When other expenses were taken into account, a bottler's average operating margin was around 8%, compared to a concentrate owner's operating margin of 32% (see **Exhibit 8** for profit margins).

Coke's original 1899 franchise agreement granted bottlers the right to manufacture and operate in an exclusive territory. They also had the right to sell their franchise contract to a third party, transferring all rights in perpetuity. The concentrate price was fixed and did not permit renegotiations, even if ingredient costs changed. In addition, bottlers could carry competitors' non-cola brands and have a final say in retail pricing decisions. Don Keough, Coke's president during the 1980s, lamented, "Every bottler on his dying bed calls his son to his side and, speaking his last words, says 'don't you ever let them [Coke] mess with that contract.'"[19]

Conflict over these contract terms eventually erupted into bitter legal disputes for Coke. In 1971, the Federal Trade Commission tried to charge that concentrate owners, including Coke, restricted competition by granting exclusive territorial rights to bottlers. But after nine years of litigation, Congress passed an act that guaranteed the concentrate makers' right to uphold that practice. Meanwhile, soaring inflation in the 1970s sent ingredient costs to unprecedented levels. Under an amended contract in 1921, Coke had been buying all raw ingredients, except sugar, at current prices, but selling the syrup to bottlers at 1921 price levels. After intense negotiations and disputes, bottlers finally agreed in 1978 to incorporate inflation in ingredient costs. In return, Coke promised to spend more on advertising support.

Despite such changes, frustrations mounted between Coke and its franchise bottlers. By the time Goizueta had become CEO, several franchises had passed on to third-generation owners. They were content to "milk the franchise" rather than investing in new equipment, trying to increase their market share, or stepping up advertising amid the cola wars.[20] "Bottlers basically did what they wanted to do, and consequently the U.S. system was not aligned," according to Tuggle. Irked by Coke's lack of control, Goizueta reversed tactics and started to refranchise the bottling business in 1980. He bought underperforming bottlers, injected them with cash to turn around operations, and then resold them to better-performing ones.

The creation of CCE The most significant acquisition came in 1985 when Goizueta seized the opportunity to buy two of Coke's biggest bottlers for $2.4 billion. That brought one-third of Coke's volume under its direct control. The purchases also saddled Coke with around $1 billion in long-term debt. In 1986, Goizueta spun off the bottling operations into a new public company, Coca-Cola Enterprises (CCE). Coke maintained a large but non-controlling 49% stake in CCE and sold the remaining 51% to the public. "We wanted influence and alignment, but not the debt on our books," said Tuggle. "We thought spinning off the bottling business was a natural step, the right thing to do at that time."

CCE, in effect, became Coke's first domestic "anchor bottler." Coke continued to buy smaller independent bottlers and sell them to CCE. Then, CCE divided geographic territories into larger regional ones and drew up new contracts with suppliers and retailers. A new 1987 Master Bottler Contract gave Coke the right to determine concentrate prices and other terms of sale for cola-flavored sparkling beverages. Coke took its anchor strategy abroad as well, creating an anchor bottler on every continent and driving consolidation. In 1991, two anchors handled about 22% of Coke's global volume; by 1996, eight anchors distributed more than 50%.[21] Coke also improved its profit margins in the 1990s by raising the concentrate price it charged bottlers, often by more than the cost of inflation.

Retailers

Supermarkets represented the biggest single distribution channel with 37% of the U.S. sparkling beverage market share. Bottlers fought to secure shelf space that could enhance visibility for their products. They also targeted impulse purchases by placing coolers at checkout counters or supermarket entrances. While the profitability of each retail channel varied according to volume sales and delivery costs, other popular outlets included fountain and vending (31%), followed by supercenters (11%)[22] (see **Exhibit 9** for profitability by retail channel).

Fountain was "quite American," as Sandy Douglas, president of Coca-Cola North America, described. "The infrastructure wasn't there to develop fountain abroad, due to issues like equipment service in some markets and water quality in others." U.S. fountain retailers and wholesalers generated 34% of Coke's domestic concentrate sales compared to overseas fountain outlets that produced 5% of the company's overseas concentrate sales.[23] Fountain syrup was usually delivered to restaurants, cafeterias, or convenience stores. There, fountain dispensers mixed drinks and poured them into glasses or disposable cups. In the United States, Coke had never franchised the business. However, in some cases, Coke paid local bottlers a fee to deliver the syrup and maintain the machines. Competition for national accounts was especially intense. Coke's major fountain accounts included McDonald's (the largest national account in terms of volume sales), Subway, and Burger King. As of 2010, Coke held 69% of the U.S. fountain business, compared to Pepsi's 20%.[24]

One notable trend over the last decade had been the rise of mass merchandisers. In 2010, about 40% of Coke's total bottler-delivered volume was with 10 key customers in the United States. Consolidation in relevant geographic markets meant more purchasing power for large retail chains. In one incident, Costco temporarily stopped carrying Coke products, as the largest U.S. wholesale club tried to get lower prices from Coke. To cut costs and offer better deals, several retailers wanted drinks to be delivered to their warehouses rather than DSD. They also wanted to negotiate directly with concentrate companies over shelf space and marketing programs.

Suppliers

Concentrate owners depended on a few key supplies—caramel coloring, phosphoric or citric acid, and caffeine. Bottlers were more dependent on the commodities market because they required packaging materials, such as aluminum and plastic. More than half of all sodas sold in the U.S. were in cans, followed by plastic bottles. In supermarkets, 12-pack cans and the 2-liter bottle were the most popular package format, while the single-serve 20-ounce plastic bottle prevailed in convenience stores.[25] Major can manufacturers, such as Ball and Rexam, had been long-term suppliers, and concentrate owners negotiated with them on behalf of their bottlers.

The Emergence of Still Beverages

A significant shift in consumers' taste preferences started to evolve in the new millennium amid calls for healthier lifestyles. Sodas were blamed for contributing to obesity. High-fructose corn syrup came under scrutiny for not being a "natural" ingredient like cane sugar. Coke responded by increasing the number of its low- or no-calorie drinks to over 800 different beverages. In particular, Coke Zero (2005) became a sensational hit. Promoted as a "The real Coca-Cola taste and zero calories," the soda was primarily marketed to young adult males. Coke Zero posted five straight years of double-digit sales gains and became the most successful soda launch since Diet Coke. The company also introduced different package sizes, including a smaller 16-ounce single-serve soda bottle. Separately, "Freestyle" machines, which could dispense over 100 different types of customized flavored soda drinks, debuted in 2009, in hopes of reviving consumers' interest in sparkling drinks.

Coke's efforts to revitalize sparkling brands, through new digital media platforms and global campaigns at sports events like the World Cup, enabled Coke brands to pull ahead of their nearest competitor. The company held a 42% market share across all retail channels in the soda category, compared to nearest competitor Pepsi's 29% share and Dr Pepper Snapple (DPS) Group's 17% share.[26] However, real growth in the NARTD market came from a different category—non-carbonated drinks, also known as still beverages. These drinks included sports drinks, enhanced water, ready-to-drink teas and coffees, energy drinks, juice, and juice drinks.

Still beverages, in general, represented a new, exciting, growth opportunity. The average growth rate for most still drinks was expected to exceed 5% over the next five years, while sparkling drinks were forecast to decline.[27] Still drinks usually commanded higher retail prices per case. For instance, juice drinks, on average, could retail for $9.95 per 192-ounce case compared to $7.85 for sodas.[28] Still beverages generated high demand in convenience stores and gas stations that triggered immediate consumption on impulse buying. At the same time, they sold in relatively low volumes compared to sodas. In the case of energy drinks, gross margins were as high as 35%, but they sold only around a billion cases in 2009. Warehouse delivery was often cheaper and preferred for such low-volume drinks, compared to the more expensive DSD system used for sparkling beverages.

Initially, Pepsi moved early and aggressively into still drinks. Between 2004 and 2006, over 70% of Pepsi's innovations were made in still drinks, while Coke heavily focused on new packaging and line extensions for its sodas.[29] Then in 2007, Coke went on a buying spree to diversify its portfolio. It bought stakes in Honest Tea and London-based Innocent Drinks that made fruit smoothies.[30] Coke also paid $4 billion for Energy Brands Inc. and gained control over vitaminwater, a popular enhanced water drink. By 2009, Coke had secured 32% of the still-beverage market compared to Pepsi's 43% by making notable gains in several key categories such as juices and enhanced water.[31]

New Industry Dynamics

Still beverages required several operational changes by both Coke and its bottlers. Consumer fragmentation was higher, with a greater number of brands and stock-keeping units (SKUs). Historically, with megabrand sodas, bottlers could fill their truck with full pallets (wooden beds used to transport drinks) of one SKU. Still beverages, given their lower-volume sales, often led to "split pallets" with multiple SKUs. Marketing and operating tactics differed as well. With still beverages, "[w]e're often at a stage where we have a brand and we're trying to figure out how to get initial consumer awareness and retail availability," according to Brian Kelley, chief product supply officer at Coca-Cola Refreshments (CCR).[32] Meanwhile, sparkling brands, which almost every household in the U.S. purchased on a regular basis, drove brand owners' attention down to the smallest details of display and points of sale to "generate whatever growth we can get out of a developed market."

Competition came not only from major beverage companies, but also from private labels. In the $10 billion juice and juice drinks market, private brands were more popular in shelf-stable and frozen juices. No single manufacturer had more than 20% of the total U.S. market share.[33] With bottled water, both Coke and Pepsi had prospered with their own brands in the early 2000s. Then the U.S. recession in 2008 sent consumers flocking to cheaper, private-label water. Pepsi's Aquafina and Coke's Dasani both saw their market share fall by more than 15% in one year.[34] By 2009, the bottled water market was locked in an intense price competition, putting pressure on profit margins. "It's a price-driven phenomenon with private labels," described Joe Tripodi, Coke's chief marketing and commercial officer. "We definitely see less of a direct threat from private brands to our core trademark cola drinks."[35]

More importantly, Coke itself became heavily involved in the production of still beverages, often referred to as "finished goods." According to Kelley, "These drinks involve a completely different proposition from sodas, from the production line to the type of equipment to packaging." They usually involved a special "hot-filled" process that pasteurized drinks at a certain temperature to eliminate impurities. It could cost $20 million for one hot-filled plant line that could produce 6 to 8 million cases a year. Coke sold these hot-filled, finished goods directly to retailers or to bottlers that delivered the beverages to stores. In essence, bottlers found themselves losing out on the profit associated with manufacturing. At the end of the decade, bottlers were reportedly only producing 60% to 70% of the total liquid refreshment beverage SKUs compared to as much as 85% of the total SKUs they were producing in 2000.[36] In addition, existing cold-filled production lines ran at lower capacity-utilization rates amid weaker demand for sparkling beverages. Bottlers, in the meantime, were unable to raise product prices enough to offset the growing costs of raw materials, labor, and distribution. Of the 70 independent Coke bottlers, nearly half stopped manufacturing altogether and focused on local distribution and marketing efforts instead.

In the retail channel, bottlers struggled with slipping demand for their most profitable 20-ounce soda bottle, sold in gas stations and convenience stores. Instead, coffee, energy drinks, and tea emerged as the top-selling beverages in these immediate consumption channels. "We actually found ourselves competing within our own system, bottlers versus the Company, since consumers could choose among bottle, can or fountain in convenience stores," said Steve Cahillane, CEO of CCR.[37] In supermarkets, one store could have more than a half-dozen people from CCE and various divisions from Coke overlap in distribution, customer management, and sales with their designed beverages.

New challenges arose with existing bottlers' franchise agreements as well. For instance, when Coke tried to get bottlers to change distribution routes to promote a new drink in certain markets, bottlers raised issues of conflict with their exclusive territorial rights. In 2006, some 50 U.S. bottlers sued Coke for trying to deliver POWERADE to Walmart warehouses. The case was settled only after Coke agreed to find a better profit-sharing model, such as compensating bottlers via royalties.

In an effort to address the fractured bottling system, Coke created a single internal organization called bottling investments group (BIG), consolidating Coke's own bottling operations and investments under one roof. Analysts often referred to the unit as the "hospital ward," because Coke bought financially distressed bottlers and tried to fix them, with the ultimate goal of spinning them off again. In 2010, four years after BIG was created, the group owned 98 bottling operations worldwide and represented 23% of Coke's net operating revenues.[38]

As for the remaining bottlers, including CCE, Coke tried to improve relations by implementing an incidence pricing model for selected concentrates. Previous agreements in the U.S. market allowed Coke to sell its concentrate at a flat rate, regardless of how the sodas were packaged and sold to consumers. That tied Coke's profits to volume growth, whereas bottlers' profits depended on which package types they sold in which channels. Under the incidence model, Coke priced the concentrate as a percentage of bottlers' revenues. It also replaced annual negotiations with multiyear agreements. "Incidence pricing totally aligned the company and bottler to drive revenue, rather than ounces. Now, everyone was on board to sell the most profitable packages and get a fairer profit split," according to CFO Gary Fayard.[39]

CCE in 2010 Despite such changes, CCE dealt with additional challenges of its own. Coke's anchor bottle strategy of consolidating its bottlers in the U.S. had continued throughout the mid-2000s, primarily through CCE. Sales rose and CCE grew to handle 75% of Coke's total North American bottle and can volume. At the same time, CCE's total debt burden exceeded $19 billion by 2005 (see **Exhibit 10** for consolidated selected financials). "The company had to put in an awful lot of capital to buy bottlers from Coke," Douglas admitted. "That dramatically increased CCE's debt levels, which impacted their willingness and ability to invest in the business." Plants ran at low utilization rates, coupled with excess capacity in certain geographical regions. Capital investments, such as adding a special machine that could integrate packaging at the end of production lines, were taking place elsewhere but not at CCE. "The financial returns of making those kinds of capital investments are unbelievably good," according to Fayard, "but CCE was just too financially strapped to do some of these obvious things."

In contrast, smaller bottlers with lighter debt loads were making new investments and pushing for greater innovation. For instance, North Carolina-based Coca-Cola Bottling Consolidated invested in new packaging—a value-priced 16-ounce bottle and a larger 24-ounce package—in 2009. The bottler outpaced the market and saw an improvement in soda sales. It also made investments to upgrade and automate its order system.

Competitors

The beverage industry, despite its early start as a highly fragmented market, went through a wave of massive consolidation by the twenty-first century. The cola wars between Coke and Pepsi, in particular, had played a major role in shaping market competition. While Coke and Pepsi collectively held 72% of the soda market, DPS Group held the distant but solid number-three position.

Pepsi

Pepsi was created in 1898 by a pharmacist in North Carolina. Like Coke, Pepsi expanded through a franchise bottling network but with a greater focus on retail sales over fountain.[40] Despite teetering on the brink of extinction a few times, Pepsi managed to revive its business, most notably in the 1970s. Pepsi expanded into other businesses as well, including snacks (Frito-Lay) and fast foods (Pizza Hut, Taco Bell, and Kentucky Fried Chicken). By 1985, Pepsi products were available in nearly 150 countries around the world. Then in 1997, Pepsi shifted gears and spun off its $10 billion restaurant business. Two years later, it exited the bottling business as well. The Pepsi Bottling Group (PBG) went public, with Pepsi retaining a 35% equity stake.

Another acquisition spree centered on drinks and snacks followed, culminating in the $13 billion purchase of Quaker Oats in 2000. The deal gave Pepsi control over Gatorade, the largest non-sparkling brand. Gatorade's double-digit growth in nearly all distribution channels led to significant gains in Pepsi's beverage sales in the following years (see **Exhibit 11** for PepsiCo's financial performance). By 2006, Pepsi held over half of the total still beverages' U.S. market share. Then Pepsi stumbled amid slipping demand for sports drinks, coupled with marketing blunders related to rebranding efforts for Gatorade and packing issues with Tropicana juice. One industry observer noted, "It was rare that such a global company made so many mistakes as Pepsi did."[41] Meanwhile, several Pepsi soda brands experienced weaker sales amid the heavier emphasis on still drinks (see **Exhibit 7**).

A key initiative of CEO Indra Nooyi's strategy to revive business was to push for a healthier, "wellness" portfolio. In some markets, full-calorie soda drinks were abandoned altogether in favor of low-calorie options. New ad campaigns promoted Sierra Mist Natural, flavored with sugar and no artificial ingredients, and Pepsi Max, a zero-calories cola. Innovation focused on "good for you" products, such as Trop 50, an orange juice made with a natural zero-calorie sweetener, stevia. Pepsi also marketed the "Power of One," the combination of its multiple snack and beverage offerings.

In line with this business approach, on August 4, 2009, Pepsi announced that it would buy the remaining equity stakes that it did not already own in two of its biggest bottlers, PBG and PepsiAmericas. The $7.8 billion price tag consolidated 80% of Pepsi's North American business volume. Nooyi claimed, "The fully integrated beverage business will enable us to bring innovative products and packages to market faster . . . and react more quickly to changes in the marketplace, much like we do with our food business."[42] Pepsi expected to generate $400 million in pretax synergies every year starting in 2012.[43] At that time, Coke declined to specifically comment about Pepsi's decision, but indicated that it stood firmly behind the franchise business model.

DPS Plano, Texas–based DPS was the third-largest player in North America with about 16% of the market. It was also the number-one player in the flavored soda category. Well-known brands under DPS included: Dr Pepper, Sunkist, A&W, Canada Dry, and Snapple. Before Pepsi's and Coke's decision to buy their bottlers, DPS had operated as the only integrated brand owner/bottler.

DPS, formerly known as Cadbury Schweppes, generated more than half of its profit from selling beverage concentrates. Over 50% of DPS's total distribution was handled by third-party bottlers. In the retail channel, DPS relied on Walmart for 13% of net sales and had a weaker presence in immediate consumption channels like convenience stores.[44] As DPS struggled to find its next big hit or expand into still beverages, the company relied on licensing agreements as another source of revenue. Both Coke and Pepsi had recently agreed that each would pay over $700 million for a 20-year licensing agreement to distribute some of DPS's most popular brands.

Reversal of Tactics

Our customers are evolving rapidly and we need a more innovative production system that will serve the market faster. This is about making the investments to strengthen our brands and creating the best infrastructure to win in the marketplace.

—CEO Muhtar Kent, 2010

On February 25, 2010, Coke announced the biggest change to its business model since 1986—it, too, was taking control of the bottling business again by buying CCE's entire North American operations. While most shareholders were caught by surprise, CEO Kent claimed that talks between the two parties had been taking place for a few years. The deal, valued at around $12 billion, was a cashless transaction. Coke assumed $8.9 billion of CCE's debt and gave up its 34% stake in CCE (worth around $3 billion at the time of the announcement). Meanwhile, CCE took over Coke's own bottling operations in Norway and Sweden. It also had the option to buy Coke's German bottling operations 18 to 36 months after the acquisition closed. In effect, CCE would become a European bottler. Coke's global franchise partners would produce and deliver 72% of Coke's worldwide volume, compared to 80% before the acquisition. But in terms of revenues, Coke would now depend on North America to generate nearly half of its sales, compared to a quarter before the announcement.

After incurring a one-time cost of $425 million, the deal was expected to generate $350 million in operational synergies over the next four years. Coke was already on track to achieve those synergies, starting with $150 million in 2011. Kelley, who headed the integration process, explained, "There are a lot of supply chain cost reductions that can take place, ranging from manufacturing to transportation to raw ingredient purchases." For example, Coke and CCE together owned 120 facilities. Rough estimates indicated that the company needed about 70% of those plants. Once overcapacity was eliminated, Kelley noted that Coke's manufacturing footprint could be redrawn to allocate resources more efficiently based on customer demographics and growth prospects. Coke cited U.S. census data projecting that 11 states representing the "southern smile" (starting from California through Florida to the Carolinas) would account for 80% of population growth to 2020. IT systems and administrative operations could be coordinated as well, adding up to additional cost savings.

To generate better structural efficiencies, Coke consolidated its North American business into a new entity, CCR. It consisted of the acquired CCE operations, plus Coke's North American food service business, Minute Maid and Odwalla juice business, supply chain operations, and bottling operations in Philadelphia. The newly integrated unit had $20 billion in sales, with nearly 70,000 employees. Cahillane, CEO of CCR, emphasized that the company could now offer comprehensive, harmonized customer services: "We have our whole product portfolio represented by CCR instead of several different people servicing the same account. This is an important synergy that we knew existed but couldn't create before." Products, such as single-servings of Simply Orange juice, could gain new points of sales that it couldn't access before because bottlers didn't handle chilled distribution. In addition, Coke could now devote more attention to expanding its points of sales, encouraged by the company's success in Philadelphia. Coke took over Philadelphia's troubled bottling operation in 2008 and identified an additional 64,000 potential points of sales. After aggressively expanding its presence in those outlets, Coke not only took over Pepsi's lead in sparkling drinks, but also turned Philadelphia into a profitable market.[45]

The Next Business Model

Executives at Coke's headquarters unanimously agreed that buying CCE's North American business was in the company's best short-term interest. Tuggle explained, "Everyone had lost confidence in our North American market and buying CCE was the best way to truly consolidate the fractured pieces." After all, despite the last few years of sluggish sales, the United States still represented the largest single market for NARTDs in the world with about 20% of total industry volume.[46] An increase in wealth could also drive future consumption, as U.S. personal expenditure per capita was expected to reach $34,000 by 2020, the highest per capita spending figure for any country.[47] Demographics could play in Coke's favor as well. Projections called for 300 million urban Americans in 2020, driven by the third-highest incremental growth in urban residents worldwide. The U.S. teen population alone was forecast to grow to 31 million by 2020.[48] In terms of product categories, still beverages were expected to generate over 45% of Coke's incremental retail sales value by 2020, creating a more balanced mix with sparkling drinks. "Given these projections, we have to and can turn North America into a growth story to achieve our 2020 vision," claimed Cahillane.

At the same time, Coke faced several decisions about the future. One question evolved around the remaining 70 independent U.S. bottlers. About half of them had been in business for a century, with territorial ownership rights that extended all over the country (see **Exhibit 12** for a map). Collectively, they accounted for around 10% of Coke's bottler-delivered volume after Coke's acquisition of CCE's business. Some Coke executives believed that the company needed a more cooperative relationship with the bottlers to deal with national customers and distribution issues. Smaller bottlers did have customer governance agreements that authorized Coke to negotiate deals on their behalf with retailers. However, Douglas noted that Coke had to be able to respond faster and better to market demands, especially in light of Pepsi's decision to control its U.S. bottling business as well. Some market analysts even hinted that Coke might eventually need to buy out the remaining bottlers to generate full supply chain efficiencies. But many bottlers had enjoyed high profits by not making new investments. Coke would need to make very generous offers to get more aggressive bottlers.

Another decision focused on creating a new manufacturing footprint that could serve the market in the most efficient and effective manner. As the still-beverage business continued to grow, Coke planned to increase its hot-filled beverages' production capacity. However, specialized, niche, still beverages were consumed in lower volumes and did not require as many plants; vitaminwater was currently produced in 10 plants, compared to around 100 plants for sparkling drinks. The company could continue to run separate plants for hot- and cold-filled beverages. Or, Coke could create a few megaplants that could handle both types of manufacturing in the long run. For instance, Anheuser-Busch, the world's largest beer company, had nearly 50% of the U.S. market share but operated just 12 breweries in the United States.[49] Owning fewer plants could create better inventory visibility, not to mention more efficient management and transportation costs.

Yet transportation costs were a concern. CFO Fayard noted that if oil prices rose above $120 a barrel in the future, transportation costs could outweigh the benefits of having a few megaplants. CCR's current distribution radius was, on average, about 130 miles from points of manufacturing to points of sales. Internal research indicated that reducing the number of plants and increasing that radius beyond 205 miles could lower profit margins. Owning the bottling business also meant that Coke had a greater exposure to commodity costs. Raw materials now consisted of about 35% of Coke's total cost of goods sold.[50] Higher commodity prices for sweeteners, aluminum, and plastic were already expected to increase Coke's cost by as much as $400 million in 2011. The company might be able to raise product prices to offset these costs, but raising prices was risky in a weak domestic economy with price-conscious consumers.

Other executives added that popular trademark Coca-Cola brands needed to stay more local. Consumption of sparkling drinks was more than double that of beer's 12% share in the total U.S. liquid-consumption market.[51] Coke owned 15 billion-dollar brands that had fast turnovers and required shorter lead times. Based on the brands' high velocity, some Coke executives argued that it made more sense to keep manufacturing close to customers.

In addition to these pressing issues, CEO Kent had to look ahead and ponder a bigger strategic question—what would the ideal business model for North America look like 10 years from now? Once North America's manufacturing and distribution had been restructured to become a world-class, efficient operation, should Coke keep the bottling business? Refranchise it? Or keep the manufacturing but franchise the distribution?

One obvious option was to keep the bottling business. Those in favor of this plan argued that Coke needed control over all sparkling and still beverages, especially given the shift in consumers' demand. Coke would have flexibility and speed to adjust to its future preferences. Complexities associated with the separate ownership of fountain versus bottle/can drinks would be eliminated. Cahillane also pointed out, "Scale has always played an important part in this industry. The bigger we get, the bigger our competitive advantage." As consolidation in the retail channel had increased retailers' pricing power, Coke would also gain more leverage over its customers. Separately, from a customer's point of view, it would be easier to deal with one unified company that handled all beverages, distribution, and customer service.

Other executives highlighted the importance of bottlers' local know-how and expertise in their respective territories. Fayard noted, "It's these relationships through local communities that have allowed Coke to build our brand momentum from the bottom up." Kelley acknowledged, "Bottlers' biggest value-added was in their local execution power, being able to engage with their consumers. We just couldn't market that on a national level."

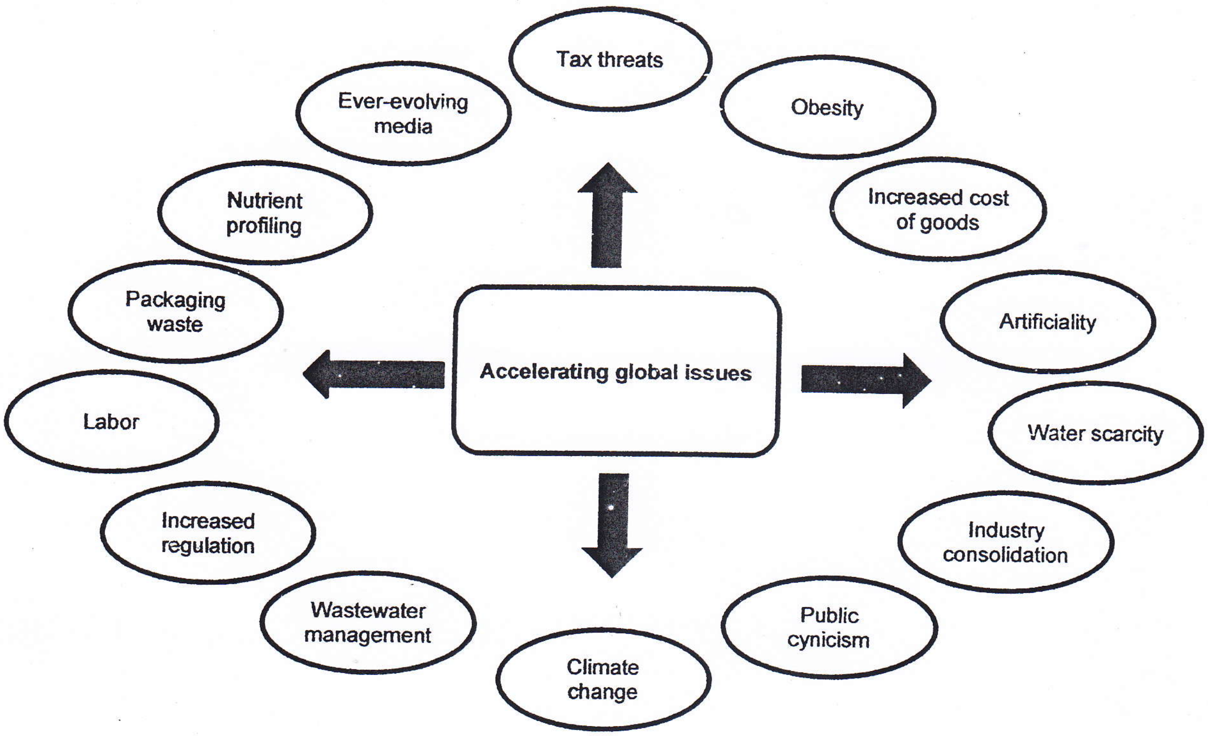
To maintain that local touch, Coke could refranchise the business and break it up into a few larger bottlers by region. This would still generate significant economies of scale in manufacturing. Coke would not have to carry the asset-intensive side of the business on its balance sheet. The franchise business model had been much more successful outside the U.S. Coke's international anchor bottlers, such as FEMSA, Amatil, and Swire, had avoided many of the challenges faced by CCE. For instance, incidence pricing had existed in Latin America for over a decade before it was adopted in the United States. That had enabled Coke to generate healthy operating margins and make new investments in the region, especially compared to North America (see **Exhibit 5**). More joint ventures could be set up as well. Several executives pointed to Jugos del Valle, a partnership set up between Coke and its Latin American bottlers in 2007. It had posted a 42% volume growth over the last two years and captured the lead in the region.[52] At the same time, some cautioned that refranchising the U.S. bottling business would create complex ownership issues again. For instance, would all regional bottlers produce hot- and cold-filled beverages? Who would get to handle new products or set prices for national retail chains?

Others leaned toward a different business model—keep manufacturing in-house but outsource the distribution. This was similar to the beer industry where Anheuser-Busch's beer distribution was handled by 600 independent distributors in the United States. Some executives argued that one entity had to manage the scope and scale of Coke's 500 brands. A centralized management system could deal with large national customers. Licensing out the trucks and distributors, again, would keep the local entrepreneurial knowledge and skills present in sales outlets. The challenge remained in motivating the distributors. If bottlers no longer manufactured soft drinks and still beverages, would there be enough margin in the business to make them aggressive distributors for Coke?

What Next?

Coke's 2010 and early 2011 performance signaled that Kent was steering the company on the right track. Business in North America posted three consecutive quarters of growth for the first time in years. Diet Coke claimed a major victory by taking over the number-two most popular sparkling drink spot from Pepsi, a position the rival had held in the United States for more than two decades. Several industry observers credited Coke's efforts to revitalize marketing for its core sparkling brands. But Kent knew that more had to be done, especially regarding the long-term franchise business model. He continued to reiterate that "[w]e are absolutely committed to the franchise system. Evolve yes, but definitely form partnerships in the North American business." What would that have to entail for Coke to win in both sparkling and still beverages, and drive a new decade of growth and prosperity?

Exhibit 1 Landscape Challenges Facing Coca-Cola



Source: Adapted by casewriter from The Coca-Cola Company, "Advancing Our 2020 Vision," presentation, October 27, 2010, p. 38.

Exhibit 2 The Coca-Cola Company's 2020 Vision

Our Mission			
To refresh the world . . . Inspire moments of optimism and happiness . . . Create value and make a difference.			
Our Vision	**Our Goals**	**Our System Priorities**	**Our Metrics**
PROFIT	More than double system revenue while increasing system margins.	**Maximize company and bottler long-term cash flow:** • Boost system investment in sales and market execution. • Operate the lowest-cost manufacturing and logistics in every market, while maintaining our quality standards. • Use our size and expertise to create economies of scale.	• Total shareowner retur • Economic profit growth • System cash flow
PEOPLE	Be a great place to work.	**Attract, engage, and retain the best talent:** • Increase people's system knowledge and cross-system movement. • Inspire our people to be passionate ambassadors for our brands. • Recruit, develop, and advance women, and achieve true diversity.	• Engagement • Employer of choice • Diversity
PORTFOLIO	More than double our servings to over 3 billion a day. Be #1 in NARTD business in every market and every category that's of value to us.	**Develop and deploy the world's most innovative and effective marketing.** **Win with Coca-Cola:** • Accelerate growth of Trademark Coca-Cola, the epicenter of our business. **Aggressively increase the value of our portfolio:** • Acquire or develop scalable, innovative premium brands. • Bring innovations to the market faster.	• Volume & value share • Servings growth • Brand health • Category ranking • # of new billion-dollar b • Commercialization • Quality index
PARTNERS	Be the most preferred and trusted beverage partner.	**Think and act like an integrated global enterprise while intensifying our local focus.** **Become a critical part of our customers' growth strategies.** **Win at the point of sale.**	• Customer relationship h • Retail sales growth
PLANET	Global leadership in sustainable water use. Industry leaders hip in packaging, energy, and climate protection.	**Create competitive advantage by fulfilling our *Live Positively* commitments:** Community, workplace, marketplace, environment.	• Reputation tracking • Environmental performa • Safety record
PRODUCTIVITY	Manage people, time, and money for greatest effectiveness.	**Design and implement the most effective and efficient business system.**	• Market-driving spending • Supply chain costs

Source: Adapted by casewriter based on The Coca-Cola Company, 2020 Vision Statement, accessed February 2011.

Exhibit 3a Coca-Cola Company's Share Price Performance, from Goizueta's Death to Isdell as CEO, 1997–2007

(October 1997 = 100)

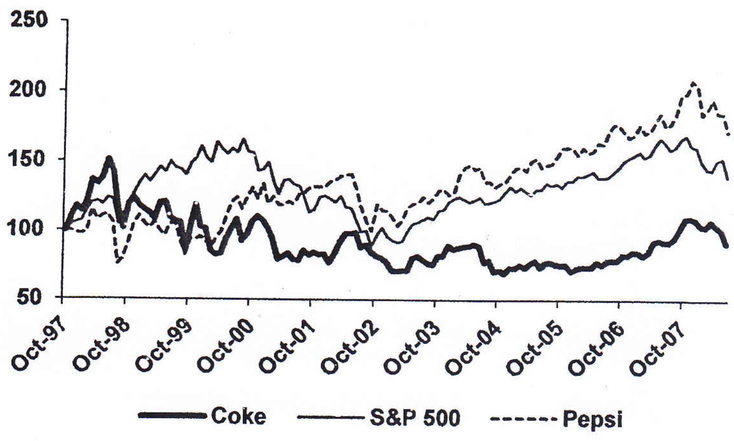
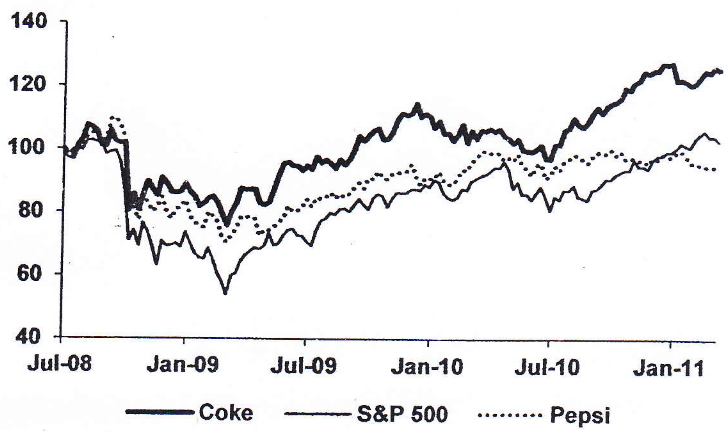


Exhibit 3b Coca-Cola Company's Share Price Performance under CEO Kent, July 2008–2011 (July 4, 2008 = 100)



Source: Thomson Reuters ONE database, accessed February 2011.

Exhibit 4 Coca-Cola Company's Selected Financials (in $ millions)

	1985	1990	1995	2000	2005	2007	2008	2009	2010[a]
Total revenues	7,904	10,236	18,127	17,354	23,104	28,857	31,944	30,990	35,119
Cost of goods sold	4,194	4,209	6,940	6,204	8,242	10,406	11,374	11,088	12,438
Gross profit	3,710	6,028	11,187	11,150	14,862	18,451	20,570	19,902	22,681
Selling, general & admin. expenses	2,665	4,076	7,161	6,016	8,739	10,945	11,774	11,358	13,084
Operating income	1,045	1,952	4,026	5,134	6,123	7,252	8,796	8,544	9,337
Net income	722	1,382	2,986	2,177	4,872	5,981	5,807	6,824	11,809
Total cash & ST investments	865	1,492	1,315	1,892	4,767	4,308	4,979	9,213	11,337
Net property, plant & equipment	1,884	2,386	4,336	4,168	5,831	8,493	8,326	9,561	14,727
Total assets	6,898	9,278	15,041	20,834	29,427	43,269	40,519	48,671	72,921
Total liabilities:	3,919	5,429	9,649	11,518	13,072	21,525	19,657	23,325	41,604
LT debt	*889*	*536*	*1,141*	*835*	1,154	*3,277*	*2,781*	*5,059*	*14,041*
Total equity	2,979	3,849	5,392	9,316	16,355	21,744	20,862	25,346	31,317
Key ratios (%)									
Gross margin	46.9%	58.9%	61.7%	64.3%	64.3%	64.0%	64.4%	64.2%	64.6%
Net income margin	9.1%	13.5%	16.5%	12.5%	21.1%	20.7%	18.2%	22.0%	33.6%
LT debt/equity	29.8%	13.9%	21.2%	9.0%	7.1%	15.1%	13.6%	20.4%	44.8%
Total liabilities/total assets	41.9%	58.5%	64.2%	55.3%	44.4%	49.7%	49.5%	49.0%	57.1%
Return on assets	10.5%	13.9%	17.4%	15.1%	12.1%	12.4%	13.1%	12.0%	9.6%
Return on capital	16.8%	20.6%	27.7%	20.9%	16.9%	17.2%	18.0%	15.9%	12.7%
Return on equity	24.2%	37.7%	56.2%	23.1%	30.2%	31.2%	27.6%	29.9%	41.9%

Source: Capital IQ database, accessed February 2011, and The Cola-Cola Company's 10K, 1985. Coke's fiscal year ends on December 31.

[a] 2010's financials include the integration of CCE's North American bottling business. The acquisition was completed in the fourth quarter of 2010, resulting in significant changes to certain financials, such as net income and total liabilities.

Exhibit 5 Coca-Cola Company's Performance by Selected Regional Operating Segment (in $ millions)

	2008	2009	2010
Latin America:			
Total net revenues	3,835	3,882	4,121
Operating income	2,099	2,042	2,405
Operating assets	1,849	2,480	2,298
Investments[a]	199	248	379
Operating margin	57.9%	55.2%	62.0%
North America:			
Total net revenues	8,280	8,271	11,205
Operating income	1,584	1,699	1,520
Operating assets	10,845	10,941	32,793
Investments[a]	4	8	57
Operating margin	19.3%	20.7%	13.6%
Bottling investments:[b]			
Total net revenues	8,931	8,320	8,313
Operating income	264	179	227
Operating assets	7,935	9,140	8,398
Investments[a]	4,873	5,809	6,426
Operating margin	3.0%	2.2%	2.8%

Source: Adapted by casewriter from The Coca-Cola Company, 2010 Annual Report. 2010 results reflect the acquisition of CCE's bottling business. Data is reported on a consolidated basis, reflecting foreign currency exchange rates.

[a] Mainly consists of equity method investments, securities, and nonmarketable investments in bottling companies.

[b] Refers to Coke's own internal bottling investment holdings.

Exhibit 6a U.S. Nonalcoholic Ready-to-Drink (NARTD) Consumption for Selected Beverages

Year	1985	1990	1995	2000	2005	2006	2007	2008	2009	2010
Sparkling soft drinks:	645	750	814	849	821	803	772	741	719	708
Regular	*517*	*527*	*600*	*639*	*579*	*566*	*541*	*522*	*504*	*496*
Diet	*128*	*223*	*214*	*210*	*242*	*237*	*231*	*219*	*215*	*212*
Bottled water[a]	72	130	162	211	312	336	360	342	330	334
Coffee[b]	430	419	341	269	262	269	256	254	253	253
Tea[b]	117	112	109	112	112	112	114	117	117	120
Juices	130	136	142	152	131	133	130	122	122	115
Sports drinks[c]	–	–	21	35	68	76	78	74	64	68
Energy drinks[d]	–	–	–	–	9	14	18	19	19	20
Tap water, hybrids, all others	577	459	497	505	439	420	395	460	514	534

Source: Adapted by casewriter from *Beverage Digest Fact Book 2011*. Data represents eight-ounce servings per person per year.

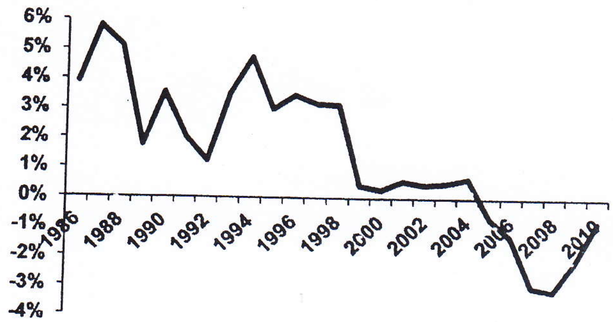
[a] Bottled water included all packages, single-serve and bulk.

[b] Coffee and tea data based on a three-year moving average.

[c] Sports drinks were included under "Tap water, hybrids, all others" before 1992.

[d] Data for energy drinks before 2005 was not available.

Exhibit 6b Year-over-Year Change in Sparkling Beverage Volume, Based on 192-Ounce Cases (%)



Source: Created by casewriter from data in *Beverage Digest Fact Book 2011*, p. 29. Growth rates exclude energy drinks.

Exhibit 7 Top-10 Sparkling Brands in the United States

Rank	Name (Owner)	Market Share In 2010	Market Share In 2005	Market Share % Change[a]	Sales in Million Cases In 2010	Sales in Million Cases In 2005	Sales in Million Cases % Change[a]
1	Coca-Cola (Coke)	17.0%	17.6%	-0.7%	1,590.0	1,796.0	-2.4%
2	Diet Coke (Coke)	9.9%	9.8%	0.2%	926.9	999.0	-1.5%
3	Pepsi-Cola (Pepsi)	9.5%	11.2%	-3.2%	891.5	1,141.8	-4.8%
4	Mt. Dew (Pepsi)	6.8%	6.5%	0.9%	633.3	659.7	-0.8%
5	Dr Pepper (DPS)	6.3%	5.7%	2.0%	592.0	578.4	0.5%
6	Sprite (Coke)	5.6%	5.7%	-0.4%	525.5	581.0	-2.0%
7	Diet Pepsi (Pepsi)	5.3%	6.0%	-2.5%	498.2	613.1	-4.1%
8	Diet Mt. Dew (Pepsi)	2.0%	1.4%	7.4%	187.5	140.5	5.9%
9	Diet Dr Pepper (DPS)	1.9%	NA	NA	174.5	NA	NA
10	Fanta (Coke)	1.8%	1.6%	2.4%	170.5	167.7	0.3%

Source: Created by casewriter from data in *Beverage Digest Fact Book 2006* and *2011*.

[a] Based on a CAGR.

Exhibit 8 Concentrate Producers and Bottlers' Profit Margins (%)

	Concentrate Producer Dollars per Equal Case	Concentrate Producer % of Net Revenue		Typical Bottler Dollars per Equal Case	Typical Bottler % of Net Revenue
Net revenue	$0.98	100%	Net revenue	$4.63	100%
Cost of goods sold	$0.22	22%	Cost of goods sold	$2.67	58%
Gross profit	$0.76	78%	Gross profit	$1.97	42%
Direct marketing	$0.21	21%	Direct marketing	$0.45	10%
Selling & delivery	$0.00	0%	Selling & delivery	$0.85	18%
General & admin.	$0.24	24%	General & admin.	$0.31	7%
Operating income	$0.30	32%	Operating income	$0.36	8%

Source: Compiled by casewriter from data provided by beverage industry sources. Figures are for all industry players.

Exhibit 9 Profitability by Retail Channel for Refreshment Beverages

	Supermarkets	Convenience Retail	Super-Centers[a]	Mass Retailers[a]	Club Stores[a]	Drugstores	Fountain, Vending, and Other	Total
Share of industry volume	37%	10%	11%	2%	7%	2%	31%	100%
Index of bottling profitability[b]								
Net price	1.00	2.24	1.13	1.10	0.93	1.23	2.09	NA
Variable profit	*1.00*	*1.24*	*1.24*	*1.39*	*1.37*	*1.68*	*1.56*	*NA*

Source: Compiled from estimates provided by beverage industry sources, October 2010. All figures refer to the entire refreshment beverage industry.

[a] "Supercenters" include Walmart Supercenter stories and similar outlets. "Mass Retailers" include standard Walmart stores, Target stores, and the like. "Club Stores" include Sam's Club, Costco, and similar membership-based retailers.

[b] Using supermarket information as a baseline, these figures indicate variance by channel of both by-volume pricing and by-volume profit. The variable profit figures take into account cost of goods sold as well as delivery costs.

Exhibit 10 CCE's Consolidated Selected Financials (in $ millions)[a]

	1990	1995	2000	2005	2007	2008[b]	2009
Total revenues	4,034	6,773	14,750	18,743	20,936	21,807	21,645
Cost of goods sold	2,359	4,267	9,083	11,258	12,955	13,763	13,333
Gross profit	1,675	2,506	5,667	7,981	7,981	8,044	8,312
Selling, general & admin. expen's	1,340	2,038	4,541	6,054	6,511	6,718	6,785
Operating income (loss)	326	468	1,126	1,431	1,470	-6,299	1,527
Net income (loss)	93	82	236	514	711	-4,394	731
Net property, plant & equipment	1,373	2,158	5,783	6,560	6,762	6,243	6,276
Total assets	5,021	9,064	22,162	25,357	24,046	15,589	16,416
Total liabilities:	3,394	7,629	19,328	19,714	18,357	15,598	15,534
Long-term debt	*1,960*	*4,138*	*10,348*	*9,165*	*7,391*	*7,247*	*7,891*
Total equity	1,626	1,435	2,834	5,643	5,689	-9	882[c]
Key ratios (%)							
Gross margin	41.5%	37.0%	38.4%	42.6%	38.1%	36.9%	38.4%
Net income margin	2.3%	1.2%	1.6%	2.7%	3.4%	-20.1%	3.4%
Long-term debt/equity	120.5%	288.4%	365.1%	162.4%	129.9%	-80,522.2%	894.7%
Total liabilities/total assets	67.6%	84.2%	87.2%	77.7%	76.3%	100.1%	94.6%
Return on assets	1.9%	0.9%	1.1%	2.0%	3.0%	-28.2%	4.5%
Return on equity	5.7%	5.7%	8.3%	9.1%	12.5%	NA	82.9%

Source: CCE's annual reports, from 1990 to 2009. All data reflects CCE's consolidated financial statements, before the acquisition of CCE's North America operations by Coke in 2010.

[a] CCE's consolidated financial statements reflect wide fluctuations, affected by issues such as, but not limited to, debt write-offs, reassessments of franchise intangible assets to fair market value, and tax charges related to restructuring activities.

[b] In 2008, CCE wrote off $7.6 billion to readjust and reflect the fair value of the company's intangible franchise assets and goodwill contracts, resulting in a significant loss for the fiscal year. For more information, see "Notes to Consolidated Financial Statements" in CCE's 2008 Annual Report.

[c] Total equity was impacted by $2.4 billion in accumulated deficit and other comprehensive losses. For more information, see "Notes to Consolidated Financial Statements" in CCE's 2009 Annual Report.

Exhibit 11 PepsiCo's Financial Performance (in $ millions)

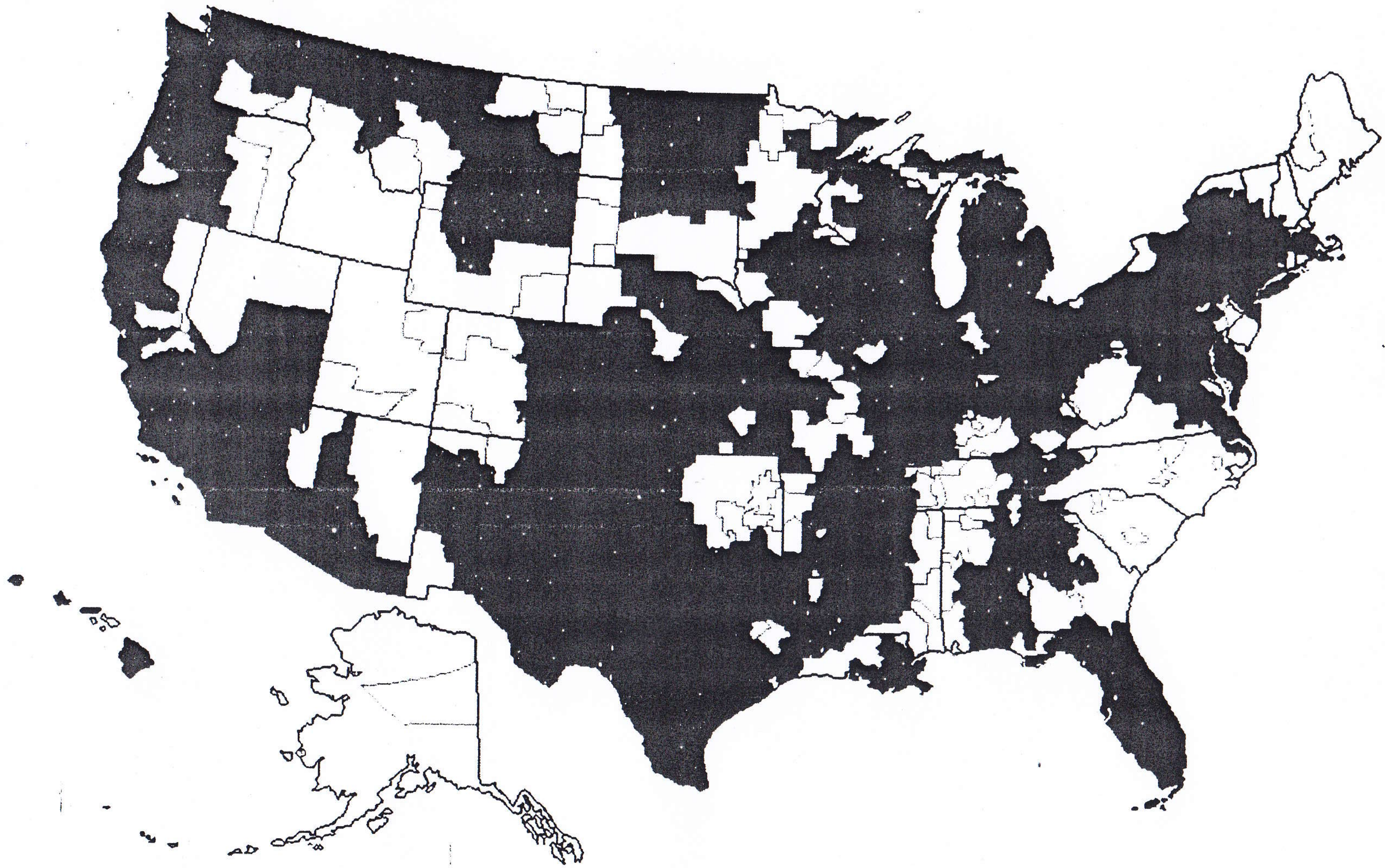
	1990	1995	2000	2005	2009	2010a
Total revenue	17,516	19,067	22,337	32,562	43,232	57,838
Cost of goods sold	8,443	8,054	10,226	14,176	20,099	26,177
Gross profit	9,073	11,013	12,111	18,386	23,133	31,661
Net income	1,077	1,606	2,543	4,078	5,946	6,320
Net property, plant & equipment	--	9,870	6,558	8,681	12,671	19,058
Total assets	--	25,432	20,757	31,727	39,848	68,153
Total liabilities:	--	18,119	13,131	17,476	22,406	46,677
Long-term debt	--	*8,509*	*3,009*	*2,313*	*7,400*	*19,999*
Total equity	--	7,313	7,626	14,251	17,442	21,476
Gross margin	51.8%	57.8%	54.2%	56.5%	53.5%	54.7%
Net income margin	6.1%	8.4%	11.4%	12.5%	13.8%	10.9%
Return on assets	NA	6.7%	13.1%	12.7%	13.4%	11.0%
Return on capital	NA	10.2%	24.1%	20.8%	22.0%	16.6%
Return on equity	NA	20.1%	35.1%	29.4%	39.8%	32.6%
Performance by segmentb						
Beverages, North America:						
Revenues	--	--	*2,657*	*9,146*	--	--
Operating income before tax	--	--	*820*	*2,037*	--	--
PepsiCo Americas Beverages (PAB):						
Revenues	--	--	--	--	10,116	20,401
Operating income before tax	--	--	--	--	*2,172*	*2,776*
Frito-Lay, North America:						
Revenues	--	--	*7,769*	*10,322*	*13,224*	*13,397*
Operating income before tax	--	--	*1,875*	*2,529*	*3,258*	*3,549*

Source: Capital IQ database, accessed March 2011. Pepsi's fiscal year ends December 31. Data for years marked as "NA" were not available.

[a] 2010's financials reflect the acquisition and integration of PGB and PepsiAmericas, which led to significant changes in the company's total liabilities and PAB's revenues.

[b] PepsiCo's sales figures include sales by company-owned bottlers. Data for "Beverages, North America" was not applicable in 1990 and 1995. As of 2000, data for "Beverages, North America" combined sales for what had been the Pepsi-Cola and Gatorade/Tropicana divisions. In 2007, Pepsi merged its North America beverage unit with Latin America, and started to report their combined financials under "PepsiCo Americas Beverages."

Exhibit 12 Coca-Cola Company's Territorial Map in the United States, after the CCE Acquisition



Source: The Coca-Cola Company. Shaded areas represent CCR territories.

Endnotes

[1] "Best Global Brands 2010," Interbrand, http://www.interbrand.com/en/best-global-brands/Best-Global-Brands-2010.aspx, accessed February 2011.

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[3] Muhtar Kent, interview by casewriters, Boston, February 2, 2011. Unless noted otherwise, all quotes from Kent come from this interview.

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[6] Allen, *Secret Formula.*

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[17] The Coca-Cola Company, Annual Report, p. 9.

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[19] Thomas Oliver, "The Real Coke, The Real Story and Infighting, Long Legal Battle, Coca-Cola Lost Competitive Edge," *Atlanta Journal and Constitution*, Sept. 21, 1986, via Factiva, accessed December 2010.

[20] Oliver, "The Real Coke."

[21] Chris Roush, "The 'Anchors' of Coca-Cola's Empire," *Atlanta Journal and Constitution*, October 13, 1996, via Factiva, accessed March 2011.

[22] *Beverage Digest Fact Book 2010*, p. 40.

[23] "The Coca-Cola Company," Citigroup Global Markets, March 10, 2010, p. 5.

[24] *Beverage Digest Fact Book 2010*, p. 59.

[25] *Beverage Digest Fact Book 2011*, p. 36. All retail channels include supermarkets, mass merchandisers, convenience stores, gas stations, vending, fountain, airlines, food services, military, and others.

[26] Coke, "Consumers Analysts Group of New York Conference 2011 Presentation," http://www.thecoca-colacompany.com/investors/index.html, p. 33, accessed March 2011.

[27] Consumer Edge Research, 2011.

[28] *Beverage Digest Fact Book 2010*, p. 15.

[29] Marc Greenberg, "Beverage Industry," Deutsche Bank Securities, May 17, 2007, p. 21.

[30] In March 2011, Coke bought the remaining 60% stake in Honest Tea it did not previously own.

[31] *Beverage Digest Fact Book 2010*, p. 102.

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[33] "U.S. Drinks and Snacks Digest," Citigroup Global Markets, February 23, 2010, p. 35.

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