# Coca-Cola's Long-Term Marketing Strategy

In May 1999, the Coca-Cola Company was examining its long-term marketing strategy to seek growth and profitability. The person heading this effort was none other than the company's CEO, M. Douglas Ivester, who was appointed to lead the company in late 1997 after the death of his predecessor, the legendary Roberto C. Goizueta.

For the Coca-Cola Company, which rode the wave of global capitalism further than almost any other U.S. multinational, the recent turbulence strikes at the core of its being. After years of solid 15 percent or better annual earnings gains, Coke® surprised Wall Street in the third quarter of 1998 with weak results. That was followed by a fourth quarter in which earnings plunged 27 percent from those in 1997. For the year 1998, Coke registered a 1 percent drop in operating income, to $4.97 billion on $18.8 billion in revenues, and was likely to be flat again in 1999. To a company that has long been considered one of America's premier growth stocks, that's akin to falling off a cliff.

Indeed, the reaction on Wall Street has been humbling. During Goizueta's 16-year reign, Coke shares rose a breathtaking 3,500 percent. But after the bad news began to pile up in the summer of 1998, Coke's stock fell by nearly a third, from 88 to around 59 in April 1999. Some investors wondered whether Coke's days of outsize returns were gone forever. Still, there were some who believed the worst might be over. Despite a dismal first quarter in which operating profits fell by 9 percent, Coke shares climbed in May 1999 to 66. **Exhibit 1** summarizes Coca-Cola's financial results. **Exhibit 2** highlights Coke's financial woes.

## CRISIS IN THE OVERSEAS MARKETS

Coca-Cola derived more than three-quarters of its profits and 71 percent of its growth outside the United States since summer of 1998; however, the global crisis had a marked impact on Coke's performance; and its sales and profits were battered by the turmoil abroad. In Brazil and Japan, two of Coke's biggest overseas markets, flattened consumer buying power left growth in 1998 almost nonexistent. In Russia, where Coke has invested more than $700 million over the past eight years, the collapse of the economy left the Coke system operating at 50 percent capacity.

The global crisis had left many thirsty people in Asia, Russia, and Latin America unable to afford a Coke. In Brazil, its third-largest market, Coke had lost more than one-tenth of its 54 percent market share to low-cost local drinks produced by family-owned bottlers exempt from that country's punitive soft-drink taxes. And in Japan, Coke's fourth-largest market, sales had been flattened both by economic turmoil and an emboldened Pepsi®, which last year signed up beverage giant Suntory as its new Japanese distributor.

## PROBLEMS AT HOME

Back at home, where Coke derived one-fifth of its profits, it faced an entirely different order of problems. Consumers here already drank more soft drinks than in any other country outside of Mexico—45 percent of it from the Coca-Cola Co. Combining that with a reinvigorated Pepsi fighting for every scrap of market share, Coke was left with less room to maneuver (see **Exhibit 3**). Almost

This case was prepared as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

**EXHIBIT 1**
***Financial Results—The Coca-Cola Company and Subsidiaries***

**Consolidated Statements of Income**

| Year Ended December 31, | **1998** | 1997 | 1996 |
|---|---|---|---|
| (In millions except per share data) | | | |
| **NET OPERATING REVENUES** | **$18,813** | $18,868 | $18,673 |
| Cost of goods sold | **5,562** | 6,015 | 6,738 |
| **GROSS PROFIT** | **13,251** | 12,853 | 11,935 |
| Selling, administrative and general expenses | **8,284** | 7,852 | 8,020 |
| **OPERATING INCOME** | **4,967** | 5,001 | 3,915 |
| Interest income | **219** | 211 | 238 |
| Interest expense | **277** | 258 | 286 |
| Equity income | **32** | 155 | 211 |
| Other income-net | **230** | 583 | 87 |
| Gains on issuances of stock by equity investees | **27** | 363 | 431 |
| **INCOME BEFORE INCOME TAXES** | **5,198** | 6,055 | 4,596 |
| Income taxes | **1,665** | 1,926 | 1,104 |
| **NET INCOME** | **$ 3,533** | $ 4,129 | $ 3,492 |
| **BASIC NET INCOME PER SHARE** | **$ 1.43** | $ 1.67 | $ 1.40 |
| **DILUTED NET INCOME PER SHARE** | **$ 1.42** | $ 1.64 | $ 1.38 |
| **AVERAGE SHARES OUTSTANDING** | **2,467** | 2,477 | 2,494 |
| Dilutive effect of stock options | **29** | 38 | 29 |
| **AVERAGE SHARES OUTSTANDING ASSUMING DILUTION** | **2,496** | 2,515 | 2,523 |

See Notes to Consolidated Financial Statements.

anywhere it turned, it faced the prospect of having to sacrifice profitability to increase sales.

With the average American already swilling more than 800 servings of soda a year, skeptics wonder how much growth could be wrung out of the United States. The flagship brands, Coke Classic and Diet Coke, are still growing at roughly 4 percent a year, but they might be approaching the limit. In recent years, consumers' appetite for colas overall have flattened—and diet soda has actually lost ground to bottled water.

Further, at the very moment he could least afford it, Ivester was being forced to expend precious resources to fight off a reinvigorated PepsiCo Inc., which was aggressively trying to win back the market share it had lost to Coke earlier this decade. Suddenly, Pepsi was fighting tooth and nail for every restaurant chain, every supermarket display, and every vending machine opportunity that came up. That new sense of purpose had forced Coke to make much costlier concessions to retain its biggest customers. Unlike past skirmishes, this Cola War

**EXHIBIT 1**
***Financial Results—The Coca-Cola Company and Subsidiaries*** *(continued)*

**Consolidated Balance Sheets**

| December 31, | **1998** |
|---|---|
| (In millions except share data) | |
| **ASSETS** | |
| **CURRENT** | |
| Cash and cash equivalents | **$ 1,648** |
| Marketable securities | **159** |
| | **1,807** |
| Trade accounts receivable, less allowances of $10 in 1998 and $23 in 1997 | **$ 1,666** |
| Inventories | **890** |
| Prepaid expenses and other assets | **2,017** |
| **TOTAL CURRENT ASSETS** | **6,380** |
| INVESTMENTS AND OTHER ASSETS | |
| Equity method investments | |
| Coca-Cola Enterprises Inc. | **584** |
| Coca-Cola Amatil Limited | **1,255** |
| Coca-Cola Beverages plc | **879** |
| Other, principally bottling companies | **3,573** |
| Cost method investments, principally bottling companies | **395** |
| Marketable securities and other assets | **1,863** |
| | **8,549** |
| **PROPERTY PLANT AND EQUIPMENT** | |
| Land | **199** |
| Buildings and improvements | **1,507** |
| Machinery and equipment | **3,855** |
| Containers | **124** |
| | **5,685** |
| Less allowances for depreciation | **2,016** |
| | **3,669** |
| **GOODWILL AND OTHER INTANGIBLE ASSETS** | **547** |
| | **$19,145** |
| LIABILITIES AND SHARE-OWNER'S EQUITY | |
| **CURRENT** | |
| Accounts payable and accrued expenses | **$ 3,141** |
| Loans and notes payable | **4,459** |
| Current maturities of long-term debt | **3** |
| Accrued income taxes | **1,037** |
| Total Current Liabilities | **8,640** |

**EXHIBIT 1**
***Financial Results—The Coca-Cola Company and Subsidiaries*** *(continued)*

| December 31, | 1998 |
|---|---|
| **LONG-TERM DEBT** | **687** |
| **OTHER LIABILITIES** | **991** |
| **DEFERRED INCOME TAXES** | **424** |
| **SHARE-OWNER'S EQUITY** | |
| Common stock, $.25 par value | |
| Authorized: 5,600,000,000 shares | |
| Issued: 3,460,083,686 shares in 1998; 3,443,441,902 shares in 1997 | **865** |
| Capital surplus | **2,195** |
| Reinvested earnings | **19,922** |
| Accumulated other comprehensive income and unearned compensation on restricted stock | **(1,434)** |
| | **21,548** |
| Less treasure stock, at cost (994,566,196 shares in 1998; 972,812,731 shares in 1997) | **13,145** |
| | **8,403** |
| | **$19,145** |

was shaping up to be a war of attrition, in which the market-share winner might turn out to be the earnings loser.

## STRATEGY FOR MARKETS ABROAD

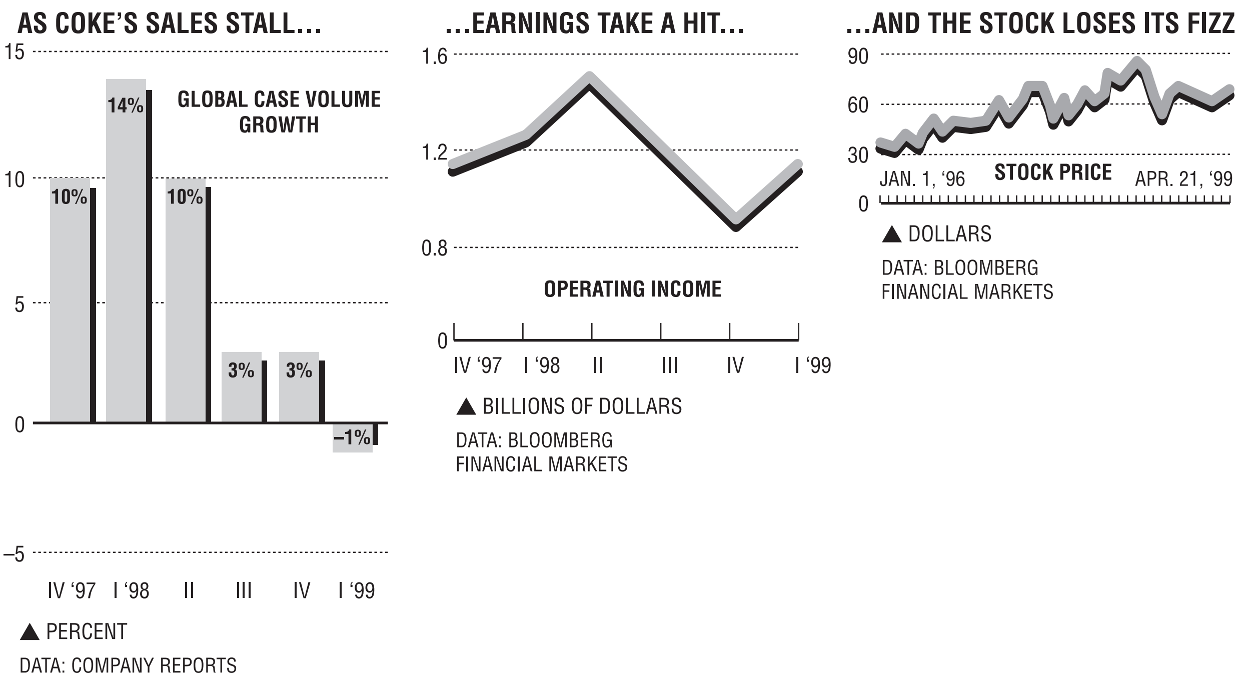
In the short run, Ivester was doing whatever it took to keep the syrup flowing. To make drinks more affordable, Coke switched from refundable glass packaging and introduced cheaper 6.5-oz. bottles. It scaled back ad campaigns in favor of in-store "instant win" promotions. In Poland, Coke bundled free candy bars with its half-liter bottles—one of several moves that had helped boost first-quarter 1999 sales there 17 percent. Costs were being cut, too: Coke's Indonesian officials, for instance, relinquished their downtown office space and moved into a bottling plant.

But Ivester did not manage just for the short term. For the long term, Ivester's response to his company's myriad problems has been remarkably consistent. Rather than pulling back as the going got rough, Ivester had repeatedly doubled his bets by spending lavishly in order to win an ever-bigger slice of the global market. That meant using the downturn as a chance to buy bottlers, distribution, and even rival brands cheap.

By investing in new capacity around the world, he was making a bet that the global economy would recover swiftly. On a recent swing through Brazil, he announced that despite the 40 percent devaluation of the real, Coke would boost its investment in Brazil by 10 percent, to $366 million and plow more than $1 billion into Africa over the next three to five years, doubling Coke's investment there. And in China, where Coke volume grew 20 percent during 1998, Coke managers were taking the ultimate long-term view, putting together a 100-year plan at Ivester's request.

Ivester argued that the investments would allow Coke to emerge from this period stronger than ever. His view was that in any crisis there was opportunity. In effect, he was betting that the big investments made in 1999 and following years, would buy Coke market share and growth opportunities in the future. It was a risky bet. In the short term, the spending spree added to the pressure on Coke's bottom line and hammered operating margins

**EXHIBIT 2**
*Coke's Financial Troubles–Coca-Cola's Long-Term Marketing Strategy*




down from historical levels of over 26 percent to 21 percent by the end of 1998. Even at its current depressed stock price, Coke traded at a price-earnings ratio of 45—a number that would surely decline if Ivester's strategy fell short. Already, Wall Street was becoming more skittish.

However, Ivester insisted in some cases that prices were just too low to pass up. Coke offered $187 million to Britain's Inchcape PLC for four bottling plants in Russia. But as the economy continued to sour, Coke eventually got them in October, 1998, for just $87 million. Still, critics warned that it could be 15 years before Coke sees a return on its Russian investments.

Coke pointed to Mexico as an example of the strength of its long-term strategy. Mexican managers boosted market share in their country from 53 percent to 68 percent by investing in new plants during the peso crisis. Coke did not break out earnings by country but says the market was "very profitable" and that volume rose 13 percent during 1998.

Ivester was not betting just on his ability to get more people around the world to drink more Coke. Having spent the past decade building a worldwide bottling system, he intended to use it to deliver any beverage that could find a big following. His boldest gambit yet was his $1.85 billion deal to acquire rights to Canada Dry, Dr Pepper, and the rest of Cadbury Schweppes PLC's soft drinks and mixers in 120 markets outside the United States—a deal that would give Coke two more percentage points of global market share, and probably more than that in time.

That was a big *if*. The deal is facing stiff resistance from regulators in such countries as Mexico

**EXHIBIT 3**
***The Pepsi Challenge—Coca-Cola's Long-Term Marketing Strategy***

The Cola Wars used to be a walkover for Coke. As relentless as a Roman legion, it regularly humbled a distracted Pepsi, widening its market-share lead. But Coca-Cola Company's easy victories are history. A newly invigorated Pepsi has launched a hellacious assault on its archrival that has forced Coke, already struggling with international woes, to expend huge chunks of money and time to defend its 44 percent to 31 percent U.S. lead.

Whipping No. 2 PepsiCo Inc. into fighting trim has been the mission of Chairman and CEO Roger A. Enrico since he took over in 1996. Enrico has made Pepsi a leaner, feistier foe by spinning off capital-intensive distractions such as restaurants and bottling. Now, with revved-up marketing, price wars in the stores, and an assault on Coke's lead in fountain and vending-machine sales, he is going after Coke with a vengeance. Says Philip A. Marineau, Pepsi's head of beverage operations: "We've reenergized our system."

**KUDOS.** Nowhere is the change more visible than in Pepsi's marketing. After years in which it pumped out glitzy ads that did not sell much, Pepsi is doubling spending—to $300 million a year—to launch a fusillade of new initiatives that are finally winning kudos from marketing experts. In March 1999, Pepsi rolled out a splashy new campaign for its flagship Pepsi-Cola brand. And to hype its new Pepsi One diet drink, the cheeky No. 2 is even dusting off its old "Pepsi Challenge" gambit from the 1970s, the last time it made gains on Coke. But perhaps its biggest move will come starting in May 1999, with the release of *Star Wars: Episode I—The Phantom Menace*. With plans to spend up to an estimated $2 billion over the six-year, three-film deal, Pepsi has scored a big piece of what should be one of the hottest promotional opportunities around. Look for Pepsi to exploit the films with toys, ads, and co-branded soft drink cans.

Out in the real world, the newly pugnacious company's chief avenue of attack is fast-food chains. Now accounting for one-quarter of all beverage sales, such chains are the fastest growing distribution channel, and, with margins of 15 percent, one of the most lucrative. Coke, with 8 of the 10 largest fast-food chains in its pocket, has a commanding 65 percent to 25 percent market share advantage. But Pepsi has scored some minor victories, stealing seven smallish fast food accounts from Coke, including Pizza Inn Inc. (525 outlets) and Bojangles' Restaurant Inc. (257). And its biggest victory may have come simply from being a contender when Coke recently renewed its contract. "The fact is, we put a scare into Coke," says a Pepsi exec. "Wait till we go after McDonald's."

Coke must also worry about Pepsi's bid to plant more of its blue vending machines around the landscape. Since 1997, Pepsi has added 170,000 machines nationwide, for a total of about 1 million. Today, Coke remains far ahead, with roughly 1.4 million machines. But Pepsi's push has made the battle to place the machines—which boast margins of more than 30 percent—far more competitive.

**SNACK TIME.** Enrico also wants Pepsi to do better at exploiting the one edge it enjoys: the combined strength of its soft drinks, its new Tropicana juice unit, and Frito-Lay, the world's largest salted-snack provider. After all, people heading to the store for a snack often pick up soft drinks at the same time. So far, the "Power of One" campaign has consisted of a few joint promotions. But Enrico is making sales calls on supermarket-chain CEOs with the heads of Frito-Lay, Pepsi, and Tropicana. Their pitch: Increase your sales by moving soft drinks next to snacks. Count on Coke, which would be at a disadvantage because it does not sell chips or pretzels, to resist Pepsi's aisle-placement plans.

The reality remains that Coke can no longer coast. "Pepsi has changed the rules," says William W. Wilson, CEO of independent Pepsi-Cola Bottling Co. of New York. "It's finally willing and able to spend big-time on catching Coke." No wonder Coke is looking over its shoulder.

*Source:* *Business Week*, May 3, 1999, p. 151

and Australia, where Coke already has a 65 percent market share. Some analysts and rivals felt that the problems stemmed as much from Coke's intransigence as its size. In France, Coke's proposed takeover of the Orangina brand has been blocked by regulators for 16 months, though analysts believe Coke would make concessions and end the impasse soon.

## STRATEGY FOR THE HOME MARKET

In the United States the company intended to spend whatever it took to hold on to key customers or sign up new ones. But not all of Coke's U.S. marketing expenditures were likely to be that lucrative. With Pepsi upping the ante, Coke must pay more to keep its most important fountain contracts. Consider the heated bidding over the 10,000-store chain of Burger King Corp., which recently came up for renewal. Burger King paid Coke about $220 million a year for 40 million gallons of soda syrup, according to industry sources. Under the old contract, Coke gave back about $25 million of that in rebates to the food chain. After Pepsi pitched Burger King for the business, Coke ended up winning, but only by doubling its rebate. That cut Coke's margins. Worse, the Burger King rebates would likely jack up the price for many of Coke's remaining contracts.

Increasingly, Coke also had to pay top dollar to sign smaller, less traditional deals. For example, a Coke bottler agreed to pay $28.5 million over ten years for sales rights across a single Michigan school district, twice what Pepsi offered. Coke thought the hefty fee, which worked out to an annual $28 per student, would pay off, since soda loyalties were often established in the teen years. Meanwhile, in the supermarket aisles, where margins were a paltry 3 percent, Coke's attempts to raise prices had hurt sales.

Additionally, Ivester had set a goal of increasing per capita U.S. consumption of all Coke products by 25 percent a year, to five hundred 8-oz. servings. That meant every American, on average should be drinking close to two cups of Coke's products every day. To get there, he was looking for new ways and new places to sell a thirsty public a Coke or a Coke product.

If Ivester had his way, consumers would soon find Coke's red-and-white machines everywhere from the local post office to the school cafeteria. Although they accounted for an estimated one-tenth of Coke's system-wide sales, vending machines carried room for a lot more. A couple of years ago, he asked execs at Coca-Cola Consolidated—his second largest U.S. bottler—to try an experiment. He wanted them to double the number of vending machines in Salisbury, North Carolina, a small city that had been budgeted for a modest 4 percent increase in capital spending. The result: Each machine generated a 30 percent to 50 percent annual return. Coke Consolidated is now adding 25,000 new vending machines. Coke is also testing a hybrid gas pump/vending machine in Pennsylvania and was working on a similar stamp/beverage machine for post offices. Further, Coke has added a host of new products in the United States, from other soft drinks such as citrus-flavored Surge, to juices, teas, and now water.

Yet even as he moved to capture a larger share of those side markets, Ivester emphatically rejected the notion that Coke had hit a permanent plateau in the United States. He said that pundits had predicted the passing of colas ever since the 1930s. During lunch in his executive dining room, Ivester compared consumption per capita for each city or region with that of another country. The per-person consumption of Coke in Lubbock, Texas, for instance, was no higher than in Chile; the consumption in Knoxville, Tennessee, was the same as that in Mexico. And consumers in Phoenix and Los Angeles—two of the lowest areas in soft-drink consumption—drink no more Coke than people in Hungary. "Why am I so optimistic about the future? Look at this map," Ivester claimed.

## IVESTER'S STYLE OF MANAGEMENT

The barrage of bad news caught Coke at a ticklish time. Managing a downdraft is tough for anyone, but Ivester, 52, had barely moved into the corner office when the numbers began to fall apart last summer. On top of that, he followed one of the most successful and revered CEOs in corporate history. For all their mutual respect and long working relationship, the two men couldn't have been more different: Goizueta, the Cuban aristocrat, and Ivester, the first in his family to attend college. The cerebral Goizueta fancied himself the master strategist who ruled at one remove. His pupil, who put in 14-hour days and stayed in contact with managers worldwide through e-mail, voice mail, and an alphanumeric pager, did not hesitate to get involved at street level, whether it was monitoring a minor acquisition in Peru or a bottler's complaint in South Africa.

The emphasis on nitty-gritty details and creative solutions were vintage Ivester. And it was a sharp departure from the arm's-length, patrician style of his predecessor. Now, 18 months into his tenure, Ivester's style and substance were being tested in ways he never could have anticipated. Although he took over one of America's most admired companies after spending years preparing for the role, the soft-spoken ex-accountant was steering a company that faced a world of trouble.

Ivester, the son of a textile-mill supervisor, gave up the partner track at accountants Ernst & Whinney to join Coke's finance staff in 1979 and had since worked in nearly every corner of the Coke empire. Under Goizueta, he executed many of the tactics that had won Coke a 50 percent share of the worldwide soda market. In 1986, Ivester engineered the ingenious spin-off of Coke's bottling operations. As European chief later in the decade, he led the push into Eastern Europe by driving a truckful of Coke into East Germany even as the Berlin Wall was falling. And, as head of Coca-Cola USA from 1991 to 1994, he introduced a plastic version of Coke's contour bottle that helped lift Coke's U.S. market share two percentage points.

Inside the Coke camp, few question that Ivester had the right stuff to take Big Red back to its glory days. Coke's board has make it clear that Ivester had its undiluted confidence.

Even as the economic winds battering Coke reached gale force, Ivester remained unflappable. In a pep talk to employees in February, Ivester was resolute that the business had not fundamentally changed, noting that Coke had weathered countless economic crises in its 113 years. "We're dealing with human thirst," Ivester told employees in his gentle Georgia accent. "There's nothing about economic change that is going to change people's thirst."

Ivester insisted that his strategy included nothing that his mentor, Goizueta, would not have done. But although Ivester might have held to his original vow of "no left turns, no right turns" after Goizueta's death from cancer in late 1997, these have been some subtle changes in the Coke culture and style. While Goizueta kept constant watch on Coke's stock and the analysts who followed it—sometimes critiquing their reports with handwritten notes—Ivester poured his energies instead into Coke's customers, no matter how small. J. L. "Sonny" Williams, president of Minyard Food Stores in Coppell, Tex., recalled how Ivester sent a red wagon after the birth of his first child last year, and then took time during a recent stop in the Lone Star State to chat over barbecue and tour one of Minyard's 85 stores. "It was nice to see a CEO who was so down to earth," said Williams. Minyard said he had never met anyone from Pepsi headquarters. Ivester claimed that if the company focuses on the customers, the business will prosper, and if the business prospers, the stock will eventually be priced right.

Ivester also began the delicate task of shifting Coke's corporate culture, which had developed a reputation in some quarters for arrogance and stodginess. To speed the decision-making process, Ivester cut several layers out of Coke's organizational hierarchy. Under Goizueta he began scrapping Coke's grueling December planning marathons with managers in favor of real-time budgeting, giving his field generals more freedom to respond to any opportunities that might arise. And, he tried to soften Coke's old "tough-love" style of management. According to Ivester, "Many employees today did not grow up in traditional households." You've got to transition to a modern style of motivating people.

And as part of that strategic effort, Ivester had encouraged more of his troops to think boldly to take more risk, even encouraging one manger who had a scheme to use a laser to beam Coke's trademark off the moon to "go for it." ("It actually would have worked," assured the manager, Steve Koonin. "But the FAA was worried about the risk of us slicing airplanes in half.")

## CONCLUSION

**Exhibit 4** summarizes Coke's challenges and problems. In the end, Ivester's biggest obstacle might be Coke's tremendous size and success. The bigger Coke gets, the harder it will be to reproduce the earnings record set by Goizueta and demanded by Wall Street. The bets Ivester had placed around the globe have added to Coke's immediate pain. But if he was right, the current crisis would not turn out to be the end of an era, simply the pause that refreshes.

**EXHIBIT 4**
***Coke's Challenges and Solutions—Coca-Cola's Long Term Marketing Strategy***

| *Challenge* | *Solution* |
|---|---|
| • **Saturated U.S. Market:** Americans already drink more than two helpings of soft drinks a day on average. | • To grab market share. Coke is striving to make its drinks available everywhere people gather—from the post office to the school cafeteria. |
| • **Rough Waters Abroad:** Coke has bet on emerging markets from Asia to South America. But with those economies devastated, getting consumers to trade cash for a soda pop is a tough sell. | • Coke's answer: cheaper packaging and smaller servings. |
| • **Stymied Acquisitions:** Attempts to snare big overseas brands such as Orangina, or the foreign rights to Cadbury Schweppes's soft drinks and mixers have been blocked by regulators. | • Observers expect Coke to eventually make concessions and close the deals. |
| • **Resurgent Pepsi:** Coke still dominates, but its nemesis Pepsi is suddenly richer and more focused. | • Coke is taking the long view, paying big bucks for the chance to bond with consumers through exclusive sales deals. |