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Coke, Top Bottler Are Near Pact To Revamp Concentrate Pricing

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Abstract (Article Summary)

The full implications of the change in pricing concentrate, the main ingredient in soft drinks, are difficult to gauge. Revenue and profits for Coke and CCE aren't expected to change immediately under a new arrangement. However, over time, some industry analysts say they believe it could alter how Coke and its bottlers share overall system profits.

In recent years, Coke's chairman and chief executive, Doug Daft, has sought to improve the relationship with CCE by adjusting the annual increases in concentrate pricing and the amount of marketing support. In 2001, Coke said it would take into account the bottler's ability to raise wholesale prices when setting annual increases on concentrate. Coke's annual increases, as high as 7% in the late 1990s, have been 1% to 2% in the past few years, and analysts are expecting an increase of 2% to 2.5% from Coke next year.

Coke also has been rejiggering the amount of marketing support it provides to CCE and making those payments contingent on CCE hitting certain volume targets. This year, CCE expects to receive about $160 million from Coke, $40 million less than planned due to weaker volume.

Full Text (795 words)

ATLANTA -- Coca-Cola Co. is nearing an agreement to overhaul its concentrate pricing with its biggest U.S. bottler, part of a larger effort to restructure its relationship with the bottler and rekindle overall growth.

For decades, Coke has sold its beverage concentrate to U.S. bottlers at the same price no matter how its soft drinks were later packaged and sold to the consumer. As a result, Coke's profits are tied to volume growth while bottler profits are driven more by the margins they get on a specific package and where drinks are sold.

Those differing incentives often put Coke and Coca-Cola Enterprises Inc., its biggest bottler, at odds over how to expand the soft-drink business. That tension has deepened as soft-drink sales have slowed and much of the industry's innovation centers on smaller bottles, such as 13-ounce plastic bottles and 8-ounce cans, which could offer higher profit margins for bottlers but less liquid volume and revenue for Coke.

John Alm, president and chief operating officer of Coca-Cola Enterprises, said a new pricing system could be agreed upon as soon as early next year that aligns the financial incentives for Coke and the bottler. CCE sells about 80% of Coke's volume in North America.

Instead of charging CCE a flat price, Coke could vary its price by package or sales channel or collect a percentage of the bottler's gross profits or wholesale prices. Coke already uses similar methods in many overseas markets.

Mr. Alm said that although the system worked well for decades, "We have to change it into a 21st century economic-sharing model."

Many on Wall Street are expecting CCE to unveil the change at its annual investor meeting Dec. 17. But Mr. Alm, who has worked closely on the change with Steve Heyer, Coke's president, doubts the details will be worked out by then since both sides are still evaluating various pricing models. Mr. Alm said the companies likely would test a new system next year before a total overhaul to minimize disruption.

Beyond pricing, Coke and CCE are rethinking their respective roles in the U.S. and whether some functions or management should be shifted among the two companies. This is being explored as part of Project Serenity, a joint three-year strategic plan being drafted by the two companies.

Coke, which owns 37.5% of CCE, declined to comment about specific changes with CCE. "We are working more closely than ever with our bottlers to ensure that we drive profitability for the entire system," a Coke spokesman said.

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Big retailers could demand lower wholesale prices, because the bottlers' concentrate prices for the relatively low-margin supermarket channel might drop under a new variable pricing system.

The change alone isn't viewed as a remedy for soft-drink sales that have gone essentially flat since 1999. But many industry observers say they believe a new pricing arrangement could promote more collaboration between Coke and CCE on much-needed breakthroughs in marketing and product innovation. "By itself this doesn't solve the problem, but the new system would better incent both Coke and CCE to do the right thing to improve system gross profit," said Bill Pecoriello, analyst at Morgan Stanley.

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A new agreement, while being drafted with CCE, could be offered to other U.S. bottlers.

PepsiCo Inc., Purchase, N.Y., said it doesn't have any plans to switch its single-price model for concentrate in the U.S.

Shaking It Up A look at Coca-Cola Enterprises -- Business: Bottling, distribution and sales of Coca-Cola Co. products andother brands -- Headquarters: Atlanta -- Employees: 74,000 -- 2002 revenue/net income: $16.9 billion/ $494 million -- Major stakeholder: Coca-Cola Co. owns 37.5% Source: Coca-Cola Enterprises