The Coca-Cola Company Struggles with Ethical Crises

Coca-Cola has the most valuable brand name in the world and, as one of the most visible companies worldwide, has a tremendous opportunity to excel in all dimensions of business performance. However, over the last ten years, the firm has struggled to reach its financial objectives and has been associated with a number of ethical crises. Warren Buffett served as a member of the board of directors and was a strong supporter and investor in Coca-Cola but resigned from the board in 2006 after several years of frustration with Coca-Cola’s failure to overcome many challenges.

Many issues were facing Doug Ivester when he took over the reins at Coca-Cola in 1997. Ivester was heralded for his ability to handle the financial flows and details of the soft-drink giant. Former-CEO Roberto Goizueta had carefully groomed Ivester for the top position that he assumed in October 1997 after Goizueta’s untimely death. However, Ivester seemed to lack leadership in handling a series of ethical crises, causing some to doubt “Big Red’s” reputation and its prospects for the future. For a company with a rich history of marketing prowess and financial performance, Ivester’s departure in 1999 represented a high-profile glitch on a relatively clean record in one hundred years of business. In 2000 Doug Daft, the company’s former president and chief operating officer, replaced Ivester as the new CEO. Daft’s tenure was rocky, and the company continued to have a series of negative events in the early 2000s. For example, the company was allegedly involved in racial discrimination, misrepresenting market tests, manipulating earnings, and disrupting long-term contractual arrangements with distributors. By 2004 Daft was out and Neville Isdell had become president and worked to improve Coca-Cola’s reputation.

We appreciate the work of Kevin Sample, who helped draft the previous edition of this case and Melanie Drexer, who assisted in this edition. This case was prepared for classroom discussion rather than to illustrate either effective or ineffective handling of an administrative, ethical, or legal decision by management. All sources used for this case were obtained through publicly available material and the Coca-Cola website.
HISTORY OF THE COCA-COLA COMPANY

The Coca-Cola Company is the world's largest beverage company, and markets four of the world's top five leading soft drinks: Coke, Diet Coke, Fanta, and Sprite. It also sells other brands including Powerade, Minute Maid, and Dansani bottled water. The company operates the largest distribution system in the world, which enables it to serve customers and businesses in more than two hundred countries. Coca-Cola estimates that more than 1 billion servings of its products are consumed every day. For much of its early history, Coca-Cola focused on cultivating markets within the United States.

Coca-Cola and its archrival, PepsiCo, have long fought the "cola wars" in the United States, but Coca-Cola, recognizing additional market potential, pursued international opportunities in an effort to dominate the global soft-drink industry. By 1993 Coca-Cola controlled 45 percent of the global soft-drink market, while PepsiCo received just 15 percent of its profits from international sales. By the late 1990s, Coca-Cola had gained more than 50 percent of the global market in the soft-drink industry. Pepsi continued to target select international markets to gain a greater foothold in international markets. Since 1996 Coca-Cola has focused on traditional soft drinks, and PepsiCo has gained a strong foothold on new-age drinks, has signed a partnership with Starbucks, and has expanded rapidly into the snack-food business. PepsiCo's Frito-Lay division has 60 percent of the U.S. snack-food market. Coca-Cola, on the other hand, does much of its business outside of the United States, and 85 percent of its sales now come from outside the United States. As the late Roberto Goizueta once said, "Coca-Cola used to be an American company with a large international business. Now we are a large international company with a sizable American business."

Coca-Cola has been a successful company since its inception in the late 1800s. PepsiCo, although founded about the same time as Coca-Cola, did not become a strong competitor until after World War II when it began to gain market share. The rivalry intensified in the mid-1960s, and the "cola wars" began in earnest. Today, the duopoly wages war primarily on several international fronts. The companies are engaged in an extremely competitive—and sometimes personal—rivalry, with occasional accusations of false market-share reports, anticompetitive behavior, and other questionable business conduct, but without this fierce competition, neither would be as good a company as it is today.

By January 2006, PepsiCo had a market value greater than Coca-Cola for the first time ever. Its strategy of focusing on snack foods and innovative strategies in the non-cola beverage market helped the company gain market share and surpass Coca-Cola in overall performance.

COCA-COLA'S REPUTATION

Coca-Cola is the most-recognized trademark and brand name in the world today with a trademark value estimated to be about $25 billion. The company has always demonstrated a strong market orientation, making strategic decisions and taking actions to attract, satisfy, and retain customers. During World War II, for example, company president Robert Woodruff committed to selling Coke to members of the armed services
for just a nickel a bottle. As one analyst said later, “Customer loyalty never came cheaper.” This philosophy helped make Coke a truly global brand, with its trademark brands and colors recognizable on cans, bottles, and advertisements around the world. The advance of Coca-Cola products into almost every country in the world demonstrated the company’s international market orientation and improved its ability to gain brand recognition. These efforts contributed to the company’s strong reputation.

However, in 2000 Coca-Cola failed to make the top ten of Fortune’s annual “America’s Most Admired Companies” list for the first time in a decade. Problems at the company were leadership issues, poor economic performance, and other upheavals. The company also dropped out of the top one hundred in Business Ethics’ annual list of “100 Best Corporate Citizens” in 2001. For a company that spent years on both lists, this was disappointing, but perhaps not unexpected, given several ethical crises.

Coca-Cola’s promise is that the company exists “to benefit and refresh everyone who is touched by our business.” It has successfully done this by continually increasing market share and profits with Coca-Cola being the most-recognized brand in the world. Because the company is so well known, the industry so pervasive, and a strong history of market orientation, the company has developed a number of social responsibility initiatives to enhance its trademarks. These initiatives are guided by the company’s core beliefs in the marketplace, workplace, community, and environment. For example, Coke wants to inspire moments of optimism through their brands and their actions, as well as creating value and making a difference everywhere they do business. Their vision for sustainable growth is fostered by being a great place to work where people are inspired to be the best they can be, by bringing the world a portfolio of beverage brands that anticipate and satisfy peoples’ desires and needs, by being a responsible global citizen that makes a difference, and by maximizing return to shareholders while being mindful of their overall responsibilities.

**SOCIAL RESPONSIBILITY FOCUS**

Coca-Cola has made local education and community improvement programs a top priority for its philanthropic initiatives. Coca-Cola foundations “support the promise of a better life for people and their communities.” For example, Coca-Cola is involved in a program called “Education on Wheels” in Singapore where history is brought to life in an interactive discovery adventure for children. In an interactive classroom bus, children are engaged in a three-hour drama specially written for the program. It challenges creativity and initiatives while enhancing communication skills as children discover new insights into life in the city.

Coca-Cola also offers grants to various colleges and universities in more than half of the United States, as well as numerous international grants. In addition to grants, Coca-Cola provides scholarships to more than 170 colleges, and this number is expected to grow to 287 over the next four years. It includes 30 tribal colleges belonging to the American Indian College Fund. Coca-Cola is also involved with the Hispanic Scholarship Fund. Such initiatives help enhance the Coca-Cola name and trademark and thus ultimately benefit shareholders. Each year 250 new Coca-Cola Scholars are designated and invited to Atlanta for personal interviews. Fifty students are then des-
CRISIS SITUATIONS

The following documents a series of alleged misconduct and questionable behavior affecting Coca-Cola stakeholders. These ethical and legal problems appear to have had an impact on Coca-Cola's financial performance, with its stock trading today at the same price it did ten years ago. The various ethical crises have been associated with turnover in top management, departure of key investors, and the loss of reputation. There seems to be no end to these events as major crises continue to develop. It is important to try to understand why Coca-Cola has not been able to eliminate these events that have been so destructive to the company.

Contamination Scare

Perhaps the most damaging of Coca-Cola's crises—and the situation that every company dreads—began in June 1999, when about thirty Belgian children became ill after consuming Coca-Cola products. Although the company recalled the product, the problem soon escalated. The Belgian government eventually ordered the recall of all Coca-Cola products, leading officials in Luxembourg and the Netherlands to recall all Coca-Cola products as well. The company eventually determined that the illnesses were the result of a poorly processed batch of carbon dioxide. Coca-Cola took several days to comment formally on the problem, which the media quickly labeled a slow response. Coca-Cola initially judged the situation to be minor and not a health hazard, but by that time a public relations nightmare had begun. France soon reported more than one hundred people sick and banned all Coca-Cola products until the problem was resolved. Soon after, a shipment of Bonaqua, a new Coca-Cola water product, arrived in Poland, contaminated with mold. In each instance, the company's slow response and failure to acknowledge the severity of the situation harmed its reputation.

The contamination crisis was exacerbated in December 1999 when Belgium ordered Coca-Cola to halt its "Restore" marketing campaign in order to regain
consumer trust and sales in Belgium. A rival firm claimed that the campaign strategy that included free cases of the product, discounts to wholesalers and retailers, and extra promotion personnel was intended to illegally strengthen Coca-Cola's market share. Under Belgium's strict antitrust laws, the claim was upheld, and Coca-Cola abandoned the campaign. This decision, along with the others, reduced Coca-Cola's market standing in Europe.

Competitive Issues

Questions about Coca-Cola's market dominance started government inquiries into its marketing tactics. Because most European countries have very strict antitrust laws, all firms must pay close attention to market share and position when considering joint ventures, mergers, and acquisitions. During the summer of 1999, Coca-Cola became very aggressive in the French market. As a result, the French government responded by refusing to approve Coca-Cola's bid to purchase Orangina, a French beverage company. French authorities also forced Coca-Cola to scale back its acquisition of Cadbury Schweppes, another beverage maker. Moreover, Italy successfully won a court case against Coca-Cola over anticompetitive prices in 1999, prompting the European Commission to launch a full-scale probe of the company's competitive practices. PepsiCo and Virgin accused Coca-Cola of using rebates and discounts to crowd their products off shelves, thereby gaining greater market share. Coca-Cola's strong-arm tactics proved to be in violation of European laws and once again demonstrated the company's lack of awareness of European culture and laws.

Despite these legal tangles, Coca-Cola products, along with many other U.S. products, dominate foreign markets throughout the world. According to some European officials, the pain that U.S. automakers felt in the 1970s because of Japanese imports is the same pain that U.S. firms are meeting out in Europe. The growing omnipresence of U.S. products, especially in highly competitive markets, is why corporate reputation—both perceived and actual—is so important to relationships with business partners, government officials, and other stakeholders.

Racial Discrimination Allegations

In the spring of 1999, initially fifteen hundred African American employees sued Coca-Cola for racial discrimination but eventually grew to include two thousand current and former employees. Coca-Cola was accused of discriminating against them in pay, promotions, and performance evaluations. Plaintiffs charged that the company grouped African American workers at the bottom of the pay scale, where they typically earned $26,000 a year less than Caucasian employees in comparable jobs. The suit also alleged that top management had known of the discrimination since 1995 but had done nothing. Although in 1992 Coca-Cola had pledged to spend $1 billion on goods and services from minority vendors, it did not seem to apply to their workers.

Although Coca-Cola strongly denied the allegations, the lawsuit evoked strong reactions. To reduce collateral damage, Coca-Cola created a diversity council and paid $193 million to settle the racial discrimination lawsuit.
Problems with the Burger King Market Test

In 2002 Coca-Cola ran into more troubles when Matthew Whitley, a mid-level Coca-Cola executive, filed a whistle-blowing suit, alleging retaliation for revealing fraud in a market study performed on behalf of Burger King. To increase sales, Coca-Cola suggested that Burger King invest in and promote frozen Coke as a child’s snack. The fast-food chain arranged to test market the product for three weeks in Richmond, Virginia, and evaluate the results before agreeing to roll out the new product nationally. The test market involved customers receiving a coupon for a free frozen Coke when they purchased a Value Meal (sandwich, fries, and drink). Burger King executives wanted to be cautious about the new product because of the enormous investment that each restaurant would require to distribute and promote the product. Restaurants would need to purchase equipment to make the frozen drink, buy extra syrup, and spend a percentage of their advertising funds to promote the new product.

When results of the test marketing began coming in to Coca-Cola, sales of frozen Coke were grim. Coca-Cola countered the bad statistics by giving at least one individual $10,000 to take hundreds of children to Burger King to purchase Value Meals including the frozen Coke. Coca-Cola’s action netted seven hundred additional Value Meals out of nearly one hundred thousand sold during the entire promotion. But when the U.S. attorney general for the North District of Georgia discovered and investigated the fraud, the company had to pay $21 million to Burger King, $540,000 to the whistle-blower, and a $9 million pretax write-off had to be taken. Although Coca-Cola disputes the allegations, the cost of manipulating the frozen Coke research cost the company considerably in negative publicity, criminal investigations, a soured relationship with a major customer, and a loss of stakeholder trust.

Inflated Earnings Related to Channel Stuffing

Another problem that Coca-Cola faced during this period was accusations of channel stuffing. Channel stuffing is the practice of shipping extra inventory to wholesalers and retailers at an excessive rate, typically before the end of a quarter. Essentially, a company counts the shipments as sales although the products often remain in warehouses or are later returned to the manufacturer. Channel stuffing tends to create the appearance of strong demand (or conceals declining demand) for a product, which may result in inflated financial statement earnings thus misleading investors.

Coke was accused of sending extra concentrate to Japanese bottlers from 1997 through 1999 in an effort to inflate profits. In 2004 Coca-Cola reported finding statements of inflated earnings due to the company’s shipping extra concentrate to Japan. Although the company settled the allegations, the Securities and Exchange Commission (SEC) did find that channel stuffing had occurred. Coca-Cola had pressured bottlers into buying additional concentrate in exchange for extended credit, which is technically considered legitimate.

To settle with the SEC, Coca-Cola agreed to avoid engaging in channel stuffing in the future. The company also created an ethics and compliance office and is required to verify each financial quarter that it has not altered the terms of payment or extended special credit. The company further agreed to work on reducing the amount
of concentrate held by international bottlers. Although it settled with the SEC and the Justice Department, it still faces a shareholder lawsuit regarding channel stuffing in Japan, North America, Europe, and South Africa.

Trouble with Distributors

In early 2006, Coca-Cola faced problems with its bottlers, after fifty-four of them filed lawsuits seeking to block Coca-Cola from expanding delivery of Powerade sports drinks directly to Wal-Mart warehouses beyond the limited Texas test area. Bottlers alleged that the Powerade bottler contract did not permit warehouse delivery except for commissaries and that Coca-Cola had materially breached the agreement by committing to provide warehouse delivery of Powerade to Wal-Mart and by proposing to use a subsidiary, CCE, as its agent for warehouse delivery.

The problem was that Coca-Cola was trying to step away from the century-old tradition of direct-store delivery, known as DSD, wherein bottlers drop off product at individual stores, stock shelves, and build merchandising displays. Coca-Cola and CCE assert they were simply trying to accommodate a request from Wal-Mart for warehouse delivery, which is how PepsiCo distributes its Gatorade brand. CCE had also proposed making payments to some other bottlers in return for taking over Powerade distribution in their exclusive territories. But the bottlers had concerns that such an arrangement would violate antitrust laws and claimed that if Coca-Cola and CCE went forward with their warehouse delivery, it would greatly diminish the value of the bottlers’ businesses.

The problems faced by Coca-Cola were reported negatively by the media and had a negative effect on Coca-Cola’s reputation. When the reputation of one company within a channel structure suffers, all firms within the supply chain suffer in some way or another. This was especially true because Coca-Cola adopted an enterprise resource system that linked Coca-Cola’s once almost classified information to a host of partners. Thus, the company’s less-than-stellar handling of the ethical crises has introduced a lack of integrity in its partnerships. Although some of the crises had nothing to do with the information shared across the new system, the partners still assume greater risk because of their relationships with Coca-Cola. The interdependence between Coca-Cola and its partners requires a diplomatic and considerate view of the business and its effects on various stakeholders. Thus, these crises harmed Coca-Cola’s partner companies, their stakeholders, and eventually, their bottom lines.

International Problems Related to Unions

Around the same time, Coca-Cola also faced intense criticism in Colombia where unions were making progress inside Coke’s plants. Coincidently, at the same time, eight Coca-Cola workers died, forty-eight went into hiding, and sixty-five received death threats. The union alleges that Coca-Cola and its local bottler were complicit in these cases and is seeking reparations to the families of the slain and displaced workers. Coca-Cola denies the allegations, noting that only one of the eight workers was killed on the premises of the bottling plant. Also, the other deaths, all occurred off premises and could have been the result of Colombia’s four-decade-long civil war.
Coke Employees Offer to Sell Trade Secrets

A Coca-Cola administrative secretary and two accomplices were arrested in 2006 and charged in a criminal complaint with wire fraud and unlawfully stealing and selling trade secrets from the Coca-Cola Company. The accused contacted PepsiCo executives and indicated that an individual identifying himself as “Dirk,” who claimed to be employed at a high level with Coca-Cola, offered “very detailed and confidential information.” When Coca-Cola received the letter from PepsiCo about the offer, the FBI was contacted, and an undercover FBI investigation began. The FBI determined that “Dirk” was Ibrahim Dimson of Bronx, New York. Dirk provided an FBI undercover agent with fourteen pages of Coca-Cola logo-marked “Classified—Confidential” and “CLASSIFIED—Highly Restricted.” In addition, Dirk also provided samples of Coca-Cola top-secret products. The source of the information was Joya Williams, an executive administrative assistant for Coca-Cola’s global brand director in Atlanta, who had access to some information and materials described by “Dirk.” Employees should be held responsible for protecting intellectual property, and this breach of confidence by a Coca-Cola employee was a serious ethical issue.

ETHICAL RECOVERY?

Despite Coca-Cola’s problems, consumers surveyed after the European contamination indicated they felt that Coca-Cola would still behave correctly during times of crises. The company also ranked third globally in a PricewaterhouseCoopers survey of most-respected companies. Coca-Cola managed to retain its strong ranking while other companies facing setbacks, including Colgate-Palmolive and Procter & Gamble, were dropped or fell substantially in the rankings.

Coca-Cola has taken the initiative to counter diversity protests. The racial discrimination lawsuit, along with the threat of a boycott by the NAACP, led to Daft’s plan to counter racial discrimination. The plan was designed to help Coca-Cola improve employment of minorities.

When Coca-Cola settled the racial discrimination lawsuit, the agreement stipulated that the company (1) donate $50 million to a foundation to support programs in minority communities, (2) hire an ombudsman who would report directly to CEO Daft, (3) investigate complaints of discrimination and harassment, and (4) set aside $36 million for a seven-person task force and authorize it to oversee the company’s employment practices. The task force includes business and civil rights experts and is to have unprecedented power to dictate company policy with regard to hiring, compensating, and promoting women and minorities. Despite the unusual provision to grant such power to an outside panel, Daft said, “We need to have outside people helping us. We would be foolish to cut ourselves off from the outside world.”

Belgian officials closed their investigation of the health scare involving Coca-Cola and announced that no charges would be filed against the company. A Belgian health report indicated that no toxic contamination had been found in Coke bottles, even though the bottles were found to have contained tiny traces of carbonyl sulfide, which produces a rotten-egg smell; the amount of carbonyl sulfide would have to have been
a thousand times higher to be toxic. Officials also reported that they found no structural problems with Coca-Cola’s production plant and that the company had cooperated fully throughout the investigation.

CURRENT SITUATION AT COCA-COLA

While Coca-Cola’s financial performance continues to lag, one issue that may have great impact on the success of the company is its relationship with distributors. Lawsuits that distributors have launched against Coca-Cola for its attempt to bypass them with Powerade have the potential of destroying trust and cooperation in the future. Other issues related to channel stuffing and falsifying market tests to customers indicate a willingness by management to bend the rules to increase the bottom line.

Although Coca-Cola seems to be trying to establish its reputation based on quality products and socially responsible activities, it has failed to manage ethical decision making in dealing with various stakeholders. An important question to consider is whether Coca-Cola’s strong emphasis on social responsibility, especially philanthropic and environmental concerns, can help the company maintain its reputation in the face of highly public ethical conflict and crises.

CEO Isdell developed a two-year turnaround plan focused on new products, and the company created one thousand new products, including coffee-flavored Coca-Cola Blak to be marketed as an energy beverage and soft drink. The company is also adopting new-age drinks such as lower-calorie Powerade sports drink and flavored Dasani water. These moves are an attempt to catch up with PepsiCo who has become the noncarbonated-beverage leader. Coca-Cola continues developing products such as bottled coffee called Far Coast and black and green tea drinks called Gold Peak. Although PepsiCo has outexecuted Coca-Cola since 1996, Coca-Cola still has a 50 percent market share, but PepsiCo has become the larger company in 2006 and Coca-Cola’s long-term earnings and sales have been lowered. If so many ethical issues had not distracted Coca-Cola, would its financial performance have been much better?