Comparison of financial conditions between coca cola and pepsi marketing essay

This report will focus on the comparison of financial conditions, especially their profits statements between Coca-Cola and Pepsi Co. for their stakeholders, like consumers, shareholders, manager, investors, and employees, creditors and lenders.

Objectives of the project

Two objectives are built to be achieved before 30th, December 2007. The major one is to help the stakeholders to know why these two companies are so successful in the past three years (2004-2006) by analyzing their financial conditions. The other one is to find these two companies' own advantages and disadvantages by comparison.

To fulfill the above two objectives, the following sub-objectives have to be done through the whole process.

To well understand their annual reports completely from the year 2004 to the year 2006. Their annual reports, from 2004 to 2006 were loaded on 20th, September 2007. During the whole process, before finishing this report, the annual reports will be read again and again.

To interview Coca-Cola China and PepsiCo China finance managers. To know about these two companies' way of financing, I will interview their finance managers at the beginning of December, and try my best to keep in touch with them until the report finish.

To know more evaluations about these two companies from others. To analyze Coca-Cola and PepsiCo more objectively, some scholars' opinions are needed. For this, I did relative research from 22nd, September 2007 to

27th, September 2007, and lend two books in terms of finance analysis, which are corporate finance and finance analysis. Information in terms of these two companies will be up dated and filled in the developing stage.

Reasons for the choice of issue

It is known that the status of profits and finance are the two major lines in the management of a successful company. They are the foundations for analyzing an organization. To assess the performance of a company, analyzing the final accounts is the common way. In order to analyze the accounts, a technique, known as the ratio analysis will be used. The whole report will mainly focus on comparing each company's absolute numerical data, and evaluating the ratios of both two companies' profitability, liquidity, use of debt and return on equity.

Justification for the choice of business

Reasons for choosing these two companies are quite clear. They are all doing the beverage business, and the company size is similar, most importantly, they are almost seizing the major beverage market, which means the number of their loyal customer is taking the largest part.

The Coca-Cola Company is the largest manufacturer, distributor and marketer of nonalcoholic beverage concentrates and syrups in the world. It is assessed as the most valuable brand in the world that owns or licenses more than 400 brands, and its products are sold in more than 200 countries. However, PepsiCo, as one of Coca-Cola's competitor, is also very competitive in the nonalcoholic beverage market. It is the second-largest food and beverage company in the world. Over the last five years, the company has

led the industry with over 8% top line growth, double-digit EPS growth and approximately $26 billion in operating cash flow, and it has returned approximately $20 billion to its stakeholders during this period.

Sources of information and Methods in use

To better accomplish this project, primary and secondary research will be used based on their following advantages.

Primary research: the results obtained from it will fill the information gap. The best way to get the primary data is to enter into the inner part of an organization, and do some practical work, like the interview, surveys and direct observation.

·Interview these two companies' finance managers.

The direct contact and communication with their finance department will get some inner information in terms of their daily management or finance which cannot be found via the Internet or libraries.

Secondary research: it can provide large amounts of information quickly and cheaply.

·Log on to the websites.

It is quite easy to get amount of secondary data through the websites, like companies' annual reports can be loaded from these two companies' websites. Also, other people's opinions which related to Coca-Cola and PepsiCo can be founded.

·Enquiry in the library.

It is really convenient to get books or magazines in terms of finance and analyze as libraries always classified data clearly, and the relevant references often beyond our expectation which provide us more choices, more knowledge and skills.

Statement of criteria

Based on the knowledge we learned from our text books, Business Accounting: an introduction and Business Accounting: advanced, two criteria will be used to assess the implications of the issue as follows.

Absolute numbers

In comparing financial statements for a number of years, it is prefer to use a variation of absolute numbers analysis which involves computes percentage changes from year to year for all financial statement. To analysis this more directly, one or two pictures of their trend will be drawn. A continuously increased extend will be expected. Also, the ratio analyze will be used.

Ratios

Ratio analysis ensures the possibility of comparison of items on one or two financial statements. After calculating ratios for each year's financial data, this report can examine the trends for each company. A relatively stead increasing trend will be expected.

Investigation Timescales

Source of information

Method in use

Dates

Cost

Primary research

Go to Pepsi-Co Beijing

23/11/2007

8RMB

secondary research

Interview the Coca-Cola Beijing

10/12/2007

14RMB

ã€€

Log on to the websites

ã€€

ã€€

download the annual reports

19/9/2007

ã€€1RMB

ã€€

download the Reading Business Financial Statements

26/9/2007

ã€€1RMB

ã€€

download the global beverage industry

4/11/2007

ã€€1RMB

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download the global 100 2006&2007

11/11/2007

ã€€0. 5RMB

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download the state industry

11/11/2007

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download the impact of exchange rates

30/11/2007

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Enquire in library

ã€€

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search the information of relevant books

19/9/2007

ã€€0

ã€€

borrow the finance analysis

20/9/2007

ã€€0

ã€€

borrow the corporate finance

30/10/2007

ã€€0

SUM

19/9-10/12/2007

27RMB

Writing Timescales

Stages

Specific actions

Date

Planning

First draft

23/9/2007

Second draft

9/10/2007

Third draft

11/10/2007

Developing

First draft

2/11/2007

Second draft

12/11/2007

Third draft

30/11/2007

Forth draft

4/12/2007

Fifth draft

6/12/2007

Sixth draft

13/12/2007

Evaluating

First draft

13/12/2007

Second draft

15/12/2007

Third draft

20/12/2007

Executive summary

Coca-Cola and Pepsi-Co are the two targets populations in this report for two purposes. The major one is to help the stakeholders to know why these two companies are so successful in the past three years, like how these two

companies can keep the return on assets ratio over 20% every year. The other one is to find these two companies' own advantages and disadvantages.

To achieve these two goals, primary research, like the interviews, and secondary research, like log on to the websites and read relatively books, are used to do the investigation. At the same time, horizontal analyze, some specific ratio analyze and trend extend are putted into practice to analysis the results of the research.

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Introduction

The Coca-Cola Company is the largest manufacturer, distributor and marketer in the world. It is assessed as the most valuable brand and owns or licenses more than 400 brands, which include fruit beverage, sports drinks, bottled water, energy drink and ready-to-drink (RTD) teas and coffees. It markets four of the world's top five carbonated soft drink (CSD) brands, including Diet Coke, Fanta and Sprite. Through the world's largest distribution system, consumers which most of them are people from 12 to 35 old in more than 200 countries imbibe Coca-Cola Company's products at a rate of 1. 4 billion serving each day. (Annual report of Coca-Cola, 2006)

However, the international markets are also the hotspots for PepsiCo. It is the second-largest food and beverage company in the world. Over the last

five years, it has 37% global market share which young people takes the biggest part, operating in 190 countries. It has led the industry with over 8% top line growth, double-digit EPS growth and approximately $26 billion in operating cash flow, and it has returned approximately $20 billion to its stakeholders during this period. (Annual report of Pepsi-co, 2006)

After the simple introduction, it can easily see that besides the products, the size, their targets customers are also the same. So, it is not hard to find that how furious their competitions are! As they are competing so strongly, customers are hard to distinguish their real strengths or weaknesses. At this time, the analysis and comparison of their finance conditions become much more important as this can provide more direct information like their profitability to their customers.

Findings

Industry background

" The full-on carbonated soft drink slump continued in 2006, marking the second consecutive year of negative volume gains. It wasn't a huge surprise given last year's performance and the trajectory the category has been on for several years. Overall the category was down about 0. 7 percent, more than last year's 0. 5 percent drop. For the most part, the story remains the same, with regular, sugared CSDs suffering the most and diets performing somewhat better. However, diet performance was nothing to write home about, with the two largest diet brands, Diet Coke and Diet Pepsi, being flat and down 1 percent, respectively. The segment's not nearly as invincible as it seemed to be just a couple of years ago." (Beverage world, 2007) Also,

they are affected by a number of factors, including, but not limited to, cost to manufacture and distribute products, consumer spending, economic conditions, availability and quality of water, consumer preferences, inflation, political climate, local and national laws and regulations, foreign currency exchange fluctuations, fuel prices and weather patterns. The appendix 1 will give a latest example of Top CSD Parent Companies.

Comparison of financial conditions between Coca-Cola and PepsiCo (Assessment of the criteria)

This report is trying to find the reasons of this industry's background through analyzing and comparing two representatives' financial conditions. To analysis these two companies financial status, this report divides the research into two parts based on the two criteria, which are comparisons of absolute numbers, and ratio analysis. Each part will be expatiated as follows.

Comparison of absolute numbers

The following part will make horizontal comparison first for each company's

main profit-related data to support the whole research.

·Coca-Cola

Net revenue

Net operating revenues increased by $984 million or 4 percent in 2006 versus 2005. Net operating revenues increased by $1, 362 million or 6 percent in 2005 versus 2004. (Annual report of Coca-Cola, 2006)

The following table indicates, on a percentage basis, the estimated impact of key factors resulting in significant increases (decreases) in net operating revenues:

Year Ended December 31

2006vs. 2005

2005vs. 2004

Increase in gallon sales

4%

3%

Structural changes

-2

0

Price and product/geographic mix

2

1

Impact of currency fluctuations versus the U. S dollar

0

2

Total percentage increase

4%

6%

(Source: annual report of Coca-Cola, 2006)

In 2006, company-wide gallon sales and unit case volume both grew 4 percent when compared to 2005. Specifically, in the major markets, like the European Union, unit case volume increased ahead of gallon sales volume due to timing of gallon sales. Both in Latin America and North America, gallon sales and unit case volume were approximately equal. In North Asia, Eurasia and Middle East, unit case volume increased ahead of gallon sales primarily due to inventory reductions in Russia.

In 2005, company-wide gallon sales grew 3 percent while unit case volume grew 4 percent compared to 2004. For instance, both in the European Union and in Latin America, gallon sales growth and unit case volume growth were even in 2005 versus 2004. In North America, gallon sales increased1 percent while unit case volume increased 2 percent, primarily due to the impact of higher gallon sales in 2004 related to the launch of Coca-Cola C2 and a change in shipping routes in 2004. In North Asia, Eurasia and Middle East, unit case volume increased ahead of gallon sales volume due to the joint acquisition of Multon, which contributed to unit case volume in 2005, along with timing of 2004 gallon sales, which impacted most of the remaining divisions in the operating segment.

In 2006, structural changes decreased net operating revenues by 2 percent compared to 2005, primarily due to the change of the business model in Spain, partially offset by the acquisitions of Bremer in the third quarter of 2005, TJC in the first quarter of 2006, CCCIL in the third quarter of 2006 and the consolidation of Bruce Phil under Interpretation No. 46(R) effective September 29, 2006.

It can be thought from the behavioral of customers, that the change of business model may affect its market share or customer's buying habits negatively, it may lose some customers who are not like changes, and this could affect the sales volume, the revenues.

In 2005, structural changes reflect the impact of a full year of revenue in 2005 for variable interest entities compared to a partial year in 2004. The favorable impact of foreign currency fluctuations in 2005 versus 2004 resulted from the strength of most key foreign currencies versus the U. S. dollar, especially a stronger euro, which favorably impacted the European Union and Bottling Investments, and a stronger Brazilian real and Mexican peso, that favorably impacted Latin America and Bottling Investments. The favorable impact of fluctuation in these currencies was partially offset by a weaker Japanese yen, which unfavorably impacted North Asia, Eurasia and Middle East.

Price and product/geographic mix increased net operating revenues by 2 percent in 2006 compared to 2005, primarily due to price increases across the majority of the operating segments and improved pricing and

product/package mix in Bottling Investments partially offset by unfavorable product mix primarily in Japan.

This fact reflect that once the price increased, the effects are quite slight for the loyalty customer's buying behaviors, which means most of them may ignore or accept the pricing increasing as it is not higher than it competitors'. However, when it is implicated in health problem, it would not so optimism. Like the failure in Japan this year, the main reason is 200 million bottles of cola are polluted, this really decrease the sales in Japan, no matter how harmful this pollution is. One point has to be mentioned here is once a company lose the customers trust, it will have to experience a long and hard efforts to redeem, and this will also directly affect the investors' decisions.

Price and product/geographic mix increased net operating revenues by 1 percent in 2005 compared to 2004, primarily due to price increases across the majority of the operating segments and improved product/package mix in Bottling Investments, partially offset by unfavorable country mix.

Total operating profit

Information about Coca-Cola's operating income contribution by operating segment on a percentage basis is as follows:

Operating Income

Year Ended December 31

2006

2005

2004

Total

3. 7%

6. 8%

9. 1%

Africa

6. 70%

6. 50%

5. 90%

East, South Asia and Pacific Rim

5. 7

4. 6

7. 7

European Union

35. 7

36. 5

37. 3

Latin America

23

19. 3

18. 5

North America

26. 7

25. 5

28. 2

North Asia, Eurasia and Middle East

24. 7

29

29. 3

Bottling Investments

-1

-8

Corporate

-22. 5

-20. 4

-18. 9 (Source:)

Demonstrated by the tables above, the percentage contribution to operating income by each operating segment fluctuated from year to year. Operating income by operating segment was influenced by a variety of factors and events including the following:

- In 2006, foreign currency exchange rates unfavorably impacted operating income by approximately 1 percent, primarily related to a weaker Japanese yen, which impacted North Asia, Eurasia and Middle East. The unfavorable impact from the weaker Japanese yen was partially offset by favorable foreign currency exchange rate changes primarily related to the euro, which impacted the European Union and Bottling Investments, and the Brazilian real, which impacted Latin America and Bottling Investments.

- In 2006, price increases across the majority of operating segments favorably impacted operating income.

- In 2006, increased spending on marketing and innovation activities impacted the majority of the operating segments' operating income.

- In 2006, operating income was reduced by approximately $3 million for Africa, $44 million for East, South Asia and Pacific Rim, $36 million for the European Union, $17 million for North Asia, Eurasia and Middle East, $88 million for Bottling Investments and $1 million for Corporate primarily due to

contract termination costs related to production capacity efficiencies, asset impairments and other restructuring costs.

- In 2005, operating income increased approximately 7 percent. Of this amount, 4 percent was due to favorable foreign currency exchange primarily related to the Brazilian real and the Mexican peso, which impacted Latin America and Bottling Investments, and the euro, which impacted the European Union and Bottling Investments.

- In 2005, operating income was impacted by an increase in net operating revenues and gross profit, partially offset by increased spending on marketing and innovation activities in each operating segment.

It can be seen that Coca-Cola makes a good balance between its costs profits.

Net income per common share from continuing operations

In 2006, net income increased 4% and the related net income per share increased 6%. These increases primarily reflect the decrease of tax rate, and the solid operating profit growth.

In 2005, net income from continuing operations increased 1% and the related net income per common share from continuing operations increased 2%. Although the tax rate was higher than 2004, and the operating profit was also lower than 2004, fortunately, the decline of the operating charges offset them partially, and made this slight increasing happen.

Besides the numerical data, it also shows the effect from the external environment, the stakeholder: government, who also can affect a company’s net income.

·Pepsi-Co

Net revenue

ã€€¼ˆIn million¼‰

FLNA

PANA

PI

QFNA

Total

Net Revenue, 2006

$10, 844

$9, 565

$12, 959

$1, 769

$35, 137

Net Revenue, 2005

$10, 322

$9, 146

$11, 376

$1, 718

$32, 562

% Impact of:

ã€€

ã€€

ã€€

ã€€

ã€€

Volume

1%

3%

6%

1%

3%

Effective net pricing

3

1

4

2

3

Foreign exchange

0. 5

—

1

1

1

Acquisitions/divestitures

0. 5

—

3

—

1

% Change(b)

5%

5%

14%

3%

8%

(Source: annual report of Pepsi-Co, 2006)

In 2006, net revenue increased 8% primarily reflecting higher volume and positive effective net pricing across all divisions. The volume gains and the effective net pricing each contributed 3 percentage points to net revenue growth. Acquisitions contributed 1 percentage point and foreign exchange contributed almost 1 percentage

point to net revenue growth.

ã€€¼ˆIn million¼‰

FLNA

PANA

PI

QFNA

Total

Net Revenue, 2005

$10, 322

$9, 146

$11, 376

$1, 718

$32, 562

Net Revenue, 2004

$9, 560

$8, 313

$9, 826

$1, 526

$29, 261

% Impact of:

ã€€

ã€€

ã€€

ã€€

ã€€

Volume

4. 50%

4%

8%

9%

6%

Effective net pricing

3

5

2. 5

3

3

Foreign exchange

0. 5

—

3

1

1

Acquisitions/divestitures

—

—

2

—

0. 5

% Change(b)

8%

10%

15%

13%

11%(Source: annual report of Pepsi-Co, 2006)

In 2005, net revenue increased 11% reflecting, across all divisions, increased volume, favorable effective net pricing and net favorable foreign currency

movements. The volume gains contributed 6 percentage points, the effective net pricing contributed 3 percentage points and the net favorable foreign currency movements contributed over 1 percentage point. The 53rd week contributed over 1 percentage point to revenue growth and almost 1 percentage point to volume growth.

Although it is not a major element, the external environment: the foreign currency also bringing some additional benefits no matter for Pepsi-Co or Coca-cola. This is mainly because foreign currency can influence a company’s future net revenue, especially for the multi-national firms.

Total operating profit

Operating Profit

ã€€

ã€€

ã€€

ã€€

ã€€

ã€€

ã€€¼ˆIn million¼‰

ã€€

ã€€

ã€€

2006

2005

2004

FLNA

ã€€

ã€€

ã€€

$2, 615

$2, 529

$2, 389

PBNA

ã€€

ã€€

ã€€

2055

2037

1911

PI

ã€€

ã€€

ã€€

1948

1607

1323

QFNA

ã€€

ã€€

ã€€

554

537

457

Total Division

ã€€

ã€€

ã€€

7127

6710

6098

Corporate

ã€€

ã€€

ã€€

-733

-788

-689

ã€€

ã€€

ã€€

ã€€

6439

5922

5409

Restructuring and impairment charges

ã€€

ã€€

ã€€

—

0

-150

Total

ã€€

ã€€

ã€€

$6, 439

$5, 922

$5, 259 (Source: annual report of Pepsi-Co, 2006)

In 2006, total operating profit increased 9% and margin increased 0. 1 percentage points. The operating profit gains reflect the net revenue growth, partially offset by the impact of higher raw material and energy costs across all divisions. The absence of the prior year's additional week reduced operating profit growth by over 1 percentage point.

In 2005, Total operating profit increased 13%. The operating profit gains primarily reflect leverage from the revenue growth, partially offset by higher selling and distribution (S&D) expenses and increased cost of sales, largely due to higher raw materials, energy and S&D labor costs, as well as higher advertising and marketing expenses.

So, from these two paragraphs, it can be concluded that the influences of direct production costs, like the material costs, and the non-production costs, like advertising and selling are much greater than they sound.

Net income per common share from continuing operations

In 2006, net income increased 38% and the related net income per share increased 40%. These increases primarily reflect the 2006 Tax Settlement, the absence of the AJCA tax charge and the solid operating profit growth.

In 2005, net income from continuing operations decreased 2% and the related net income per common share from continuing operations decreased 1%. These decreases reflect the impact of the tax items discussed above, partially offset by the operating profit growth, and increased bottling equity income.

(Source:)

After the horizontal comparison of each company, the basic financial situation can be seen clearly that both Coca-Cola and Pepsi-Co are running stably. However, what are the subtle differences behind this result between them? The following ratio analysis will try to find the answer.

Ratio analysis

· Profitability ratio

a. Net profit margin (NPM) = net income/ sales

2004

2005

2006

Coca-cola

22. 29%

21. 09%

21. 09%

Pepsi-co

14. 39%

12. 52%

16. 06%

(Source:)

Net profit margin is very useful when comparing companies in similar industries. A higher profit margin indicates a more profitable company that has better control over its costs compared to its competitors. (investopedia. com 2007) This ratio is determined by the net income and sales.

For Coca-Cola, the net income from 2004 to 2006 was steadily increased from $4, 847 million to $4, 872 million and $5, 080 million in 2006, while its net sales also increased from $21, 747 million in 2004 to $23, 104 million in 2005 and $24, 088 million in 2006. As both elements were increased in the last three years, why there was still a 1% decreasing in 2005? From the consolidated statements of income (see appendix 2), it can be found that the income tax was increased from $1, 375million in 2004 to $1, 706million

in 2005, this is the main reason why its net income increased so slightly. However, it can be found that the income before tax in 2006 was $6578 million, lower than $6690 million in 2005. This gap was caused by the other operating charges, which was increased sharply from $85million to $185 million, and the increase of cost of sales from $7, 674 million in 2005 to $8, 195 million in 2006. Fortunately, the decrease of income tax from $1, 706 million in 2005 to $1, 498 million in 2006 helped the increase of net income.

A decrease of net profit margin also appeared in Pepsi-CO in 2005. This was mainly because the increase of income tax, from $1, 372 million to $2, 304 million, and this directly caused the net income was lower than 2004’s. However, in 2006, as the income tax decreased sharply from $2, 304 million to $1, 347 million, and the control of cost of sales was very efficient (only increased $1, 586 million as its net sales increased $2, 575 million), the net profit margin increased 4% points in 2006.

(Source:)

Comprehensively speaking, combine the comparison chart above, Pepsi-Co’s ability of cost control is much stronger than Coca-Cola’s. If the count put aside the income tax part, Pepsi-Co would show a steadier, more positive and ore optimism increasing trend than Coca-Cola. This phenomenon is a good example of the uncontrollable influence from organization’s external environment which could affect the profit largely.

b. Return on capital employed= net profit before tax/ ordinary shareholders equity *100%

2004

2005

2006

Coca-cola

39. 05%

40. 90%

38. 88%

Pepsi-co

40. 86%

44. 57%

45. 25%

(Source:)

This ratio is used as an indication of the level of return on ordinary share capital. (Accounting: advanced, SQA)

For Coca-Cola, this ratio has had increased from 39. 05% in 2004 to 40. 90% in 2005. This is a healthy sign that indicates shareholders are receiving larger dividends. The change is due to the increase of net profit before tax from $6, 222 million to $6, 990 million year on year. Existing shareholders would be happy with their return and potential shareholders might be

persuaded to invest. However, the return on capital employed has decrease from 40. 9% in 2005 to 38. 8% in 2006. This is not a healthy sign and is due to the increase of ordinary shareholders equity. This might means that this is now being apportioned amongst a greater number of shareholders. Existing shareholders will be unhappy with this lower return and potential shareholders will be discouraged from investing.

For Pepsi-Co, this ratio increased year by year. This is due to the increase of net profit before tax from 2004 to 2006, and the results can do affect shareholders positively. At the same time, it is a strong evidence to encourage the potential shareholders to invest.

So, from the analysis of this ratio, the statement of retur