

Economic Impact of the Coca-Cola System on China

Chapter 2: Coca-Cola with Chinese Characteristics

Introduction

Each day, more than one billion servings of Coca-Cola products are consumed across the world. As the world's most pervasive brand reaching almost 200 countries, Coca-Cola products are sold in highly diverse markets. Success in any market is not the result of a monolithic global strategy or single system. While Coca-Cola concentrate is one of the world's most invariant formulae, the Coca-Cola system itself is highly adaptable. The complex of suppliers, bottling plants, and distribution outlets responsible for making and delivering the product to consumers adapts to local conditions and requirements in each market Coca-Cola serves.

China's local markets pose many distinct challenges, even to seasoned multinational business systems. The country's vast regional differences, rapid development, and sheer size render any simple approach to entry and expansion impossible. Coca-Cola has pioneered a flexible approach to localization that has important implications for the economic reform process. In the process of localizing production and distribution, the result has been, to borrow the well-known phrase from Deng Xiaoping theory, a Coca-Cola system "with Chinese characteristics." Essentially, Coca-Cola has had to continually re-evaluate its Chinese business system. Although Coca-Cola products are sold globally, there is no single model that fits all economies, no matter the size or shape. To manufacture and distribute soft drinks in China's many markets, the multinational parent, the country office, and an array of Chinese businesses must constantly search for the right approach to localization. In all cases, success depends on a core alliance of highly competent bottlers, suppliers and distributors. This chapter provides background on the development of the Coca-Cola system in China, discussing the history of the business as well as the current structure.

History

Almost since its inception, Coca-Cola has been available in overseas markets. Using technology and sales know-how honed for only 15 years in the United States, The Coca-Cola Company first entered Asian markets at the beginning of the 20th century. Between the first and second world wars, under the leadership of Chairman Robert W. Woodruff, the expansion spread widely. One of Woodruff's goals was to localize Coca-Cola production in overseas markets, sourcing glass bottles, caps, machinery, and personnel.¹

China figured prominently in this early period of Coca-Cola's overseas operations under Woodruff. Coca-Cola products have been available in China since the early 1920s. Originally, bottles were imported from Coca-Cola's manufacturing base in the Philippines. Then, in 1927,

The Coca-Cola Company appointed two Chinese bottlers (in Shanghai and Tianjin). In 1930, a third was added in the northeastern coastal city of Qingdao. Coca-Cola's early operations in China were positioned for long-term growth, primarily in coastal China. In 1933, Shanghai ranked as the largest Coca-Cola bottling plant outside the United States.

While the Japanese took over many plants during their World War II occupation, Coca-Cola returned to China quickly after the Japanese surrender. Immediately after the war in 1945-46, Guangzhou, then known as Canton in the West, also became a Coca-Cola bottler location. As evidence of the interest in and commitment to China, Woodruff visited Shanghai and Tianjin in 1947. Just before the founding of The People's Republic of China in 1949, the Shanghai plant, the most modern, fastest bottling line in China, reached a major benchmark: it was the first plant outside the United States to sell one million cases annually. The customer base was narrow, however. Coca-Cola distribution served primarily the large expatriate community in Shanghai.

In 1949, China asked all foreign companies to leave. Coca-Cola plants were nationalized, and The Company lost permission to import concentrate. Premier Zhou Enlai ordered that the machinery in the bottling plant in Shanghai be dismantled and shipped to Beijing, where it would be used to produce soft drinks for newly formed state enterprises. Direct production by foreign-owned beverage manufacturers in the People's Republic of China ceased for more than thirty years.

The beverage industry showed little development during the first three decades of the People's Republic of China. Before 1978, "Juzi Qishui," an orange-flavored carbonated beverage sold in glass bottles was the only soft-drink beverage distributed across the Chinese market. The former Coca-Cola plants struggled to survive under the changing circumstances of the early years of the People's Republic, the Great Leap Forward (1958-59), and the Cultural Revolution (1966-1976). A case in point is the Tianjin facility. In 1953, the Chinese government officially took over the Tianjin Coca-Cola plant; the Japanese had controlled it during the war. The Tianjin factory began producing a carbonated soft drink under the Crystal label and later lemonade and orange juice under the Shanhaiguan label. In 1956, 40 soft drinks factories were merged with Crystal to become the Shanhaiguan Company. Yet, the basic equipment, already aging, would not be upgraded for the next two decades.

The overall beverage market was fragmented during the Cultural Revolution period of the 1960s and 1970s. At one time, there were 60 carbonated soft-drink factories in Tianjin alone, including those operated by the People's Liberation Army and various collectives. Many were small and inefficient. With the profusion of producers, profits plummeted. In 1980, the Tianjin factory moved to a new building and installed imported equipment

Major Milestones 1927-1982

1927

The Coca-Cola Company first established bottling plants in Shanghai and Tianjin.

1948

Shanghai becomes the first market outside the United States to post annual sales of more than 1 million unit cases.

1979

The Coca-Cola Company reenters the Chinese market, following the re-establishment of relations between China and the United States. The first batch of 28,000 cases of Coca-Cola cans and bottles are transported from Hong Kong to Guangzhou, Shanghai, and Beijing.

1980

In Beijing, groundbreaking in Beijing of the first Coca-Cola plant in China following reentry.

1981

Guangzhou Coca-Cola bottling plant groundbreaking.

1982

First FIFA/Coca-Cola Football Academy is held in Beijing.

from Romania, which was far behind Western efficiency standards. Overall, the soft-drink industry stagnated throughout the country until the open door policy of the late 1970s and early 1980s.

In 1979, when China began to welcome foreign participation in its economy, the industry developed rapidly. Over the next 20 years, the beverage industry as a whole (including carbonated beverage, bottled water, and fruit and vegetable juices) expanded. In 1980, the total national output of beverage was less than 300,000 tons. By 1985, output jumped to one million tons, and then to 3.3 million tons in 1990, then reaching 10.69 million tons in 1997. In other words, beverage output was 36 times that of 1980, an annual increase of 23.7 percent during the 17 years. The Chinese nonalcoholic beverage market is now over 34 billion RMB (\$4 billion at current exchange rates), with imports accounting for less than 2 percent. Imports are low because foreign beverage firms have opened many joint ventures to produce beverages in China, thereby reducing shipping costs and serving Chinese consumers better.

Coca-Cola embarked on a long-term reentry strategy almost immediately after Chinese leader Deng Xiaoping announced in 1978 that China would permit foreign direct investment. According to Chinese policies toward foreign direct investment in China, carbonated beverages fell under the category of "controlled" (*kongzhi*), as opposed to "encouraged" (*guli*) or "prohibited" (*jinzhi*). Thus, proposed foreign investment was subject to Chinese government approval on a case-by-case basis. Coca-Cola opened lines of communication with the Chinese government, ensuring them that the Coca-Cola system, which would bring China hundreds of millions of dollars in investment, and would make a long-term commitment to economic development in the consumer goods industry. Top management in Atlanta dispatched representatives to China charged with putting a new Coca-Cola system in place throughout the value chain: production, sales, marketing, and distribution.

In 1978, when the Carter Administration was negotiating the resumption of formal United States-China diplomatic relations at the Beijing Hotel, Coca-Cola management was down the hall negotiating The Company's return to China. Coca-Cola signed its deal with Chinese authorities three days before the U.S. government concluded its negotiations. Indeed, the U.S. government announced the normalization of diplomatic relations on December 15, 1978, and Coca-Cola announced its resumption of sales in China the same day.

The re-introduction of Coca-Cola in China began in 1979 with a limited period in which the products were imported. Cans came from California; bottles from Hong Kong. Coca-Cola first shipped 30,000 cases to Guangzhou, Shanghai, and Beijing. At that time, Coca-Cola could only be sold to foreigners (e.g., in hotels and in

Major Milestones 1983-1990

1983
Xiamen Coca-Cola
bottling plant ground-
breaking.

1984
Fanta and Sprite are
launched after produc-
tion starts in Xiamen
plant. First foreign
commercial airs on
China Central Televi-
sion; it is for Coca-
Cola.

1985
Zhuhai Coca-Cola
plant, the first joint
venture in the system,
begins production.

1986
Shanghai Pudong
Coca-Cola plant
groundbreaking.
Coca-Cola organizes
the first Asian
Coca-Cola Cup foot-
ball tournament in
China.

1987
Nanning and Dalian
plants start production.

1988
First Coca-Cola con-
centrate plant starts
production in Shang-
hai. Coca-Cola sup-
ports the China Na-
tional Games in
Guangzhou.

1989
Nanjing and Hangzhou
plants start production.

1990
Tianjin plant begins
production. Coca-Cola
sponsors the Asian
Games in Beijing.

friendship stores, which were limited to foreigners, and for which hard currency was required). Meanwhile, plans were made for a new Coca-Cola plant in Shanghai, China's most populous city, which was often used as a test market for food and beverage products.

Innovation and flexibility were needed to make a long-term investment strategy work in China. The lack of a presence in China for 30 years did not deter management. Coca-Cola had now invested throughout much of Asia and had strong competitive advantages in the soft-drink business. Besides brand recognition, Coca-Cola had unrivaled expertise in production and distribution.

Thus, in the early years of China's opening to foreign trade and investment, Coca-Cola was one of the first multinational enterprise systems to consider long-term localization. As demand for the imported product grew quickly, Coca-Cola needed to accelerate the process of getting the product to the market. In an unusual step for the Atlanta-based company, Coca-Cola at first sold concentrate, but owned no bottling plants. Instead, Coca-Cola set up operations for the Chinese government, refurbishing old plants and building new facilities—directly transferring capital and technology to China.

In the 1980s and 1990s, the actual Coca-Cola bottling and distribution system began to take shape through joint ventures with Chinese partners. Then, Coca-Cola embarked on a process of input localization, and continued to build its distribution infrastructure as The Company had done under Woodruff in the 1920s and 1930s. In 1980, Coca-Cola reached agreement with state-owned China National Cereals, Oils, and Foodstuffs Import and Export Corporation (COFCO) to set up a plant in Beijing (instead of the plant originally planned for Shanghai). Coca-Cola built the plant for \$2.7 million and gave it to the Chinese government in return for permission to expand sales and distribution in China. At first, concentrate was imported into China from the United States. The Beijing plant was completed in 1981 and officially opened by Coca-Cola's first foreign-born leader, Roberto Goizueta (at the time, the newly designated Chairman of The Coca-Cola Company). In 1982, Coca-Cola started to build a new plant in Guangzhou, approved by President Jiang Zemin, who was then serving on the Chinese Government's Export Committee. The Coca-Cola Company also granted this plant to the Chinese government. In return, Coca-Cola received payment for the concentrate supplied to the plants in both Beijing and Guangzhou.

In 1984, Coca-Cola built a bottling plant in Xiamen, one of China's newly designated "special economic zones" (SEZs), which were given permission to grant foreign investors special tax privileges and other investment incentives. Xiamen is located in Fujian Province, opposite Taiwan. Owned by China's former Ministry of Light Industry (now known as the State Light Indus-

Major Milestones 1991-1999

1991
Hainan plant starts production.

1993
Master plan for building 10 new Coca-Cola bottling plants approved by Ministry of Light Industry.

1994
Coca-Cola's system begins commitment to Project Hope; builds 50 schools and 100 libraries over next 5 years.

1995
Wuhan, Xian, and Shenyang plants start production

1996
Zhengzhou and Harbin plants start production.

1997
Qingdao, Dongguan plants start production. Dongguan is the first Coca-Cola plant to produce non-carbonated beverages.

1998
Hefei and Taiyuan plants start production.

1999
Chengdu and Kunming plants start production. The Coca-Cola Company celebrates 20th anniversary of its return to China by opening a US\$38 million expansion to its Beijing plant.

try Bureau, reporting to the State Economic and Trade Commission), the plant produced Fanta and Sprite in addition to Coca-Cola. Also in 1984, Coca-Cola's Macau bottler brought an old bottling line and three vehicles to Zhuhai (the SEZ next to Macau) and set up a joint venture. This was the first joint venture in the Coca-Cola system in China. The Coca-Cola Company signed the joint-venture agreement with the former Ministry of Light Industry.

While building a production capability, The Coca-Cola Company also worked to improve its brand recognition in China. In another significant milestone in 1984, Coca-Cola underwrote coverage of the British queen's trip to China on China's Central Television station (CCTV). In return, CCTV permitted a Coca-Cola commercial to air on the state-run network—the first foreign commercial on China's Central Television station. Thereafter, CCTV permitted foreign advertising. The products of Coca-Cola were thus being advertised throughout China before they became commercially available to Chinese consumers.

The most significant event of 1984, however, came during a landmark meeting between Yang Bo, China's Minister of Light Industry, and Coca-Cola's top management team at the Atlanta headquarters. The Ministry of Light Industry delegation had traveled throughout the world and concluded that the Chinese could learn a great deal from foreign beverage manufacturers and distributors. Minister Yang signed a letter of cooperation with The Coca-Cola Company to form cooperative manufacturing facilities in China, starting with Tianjin, Shanghai, and Qingdao—cities in which Coca-Cola had been bottled before 1949. A joint task force was established involving the Ministry of Light Industry and The Coca-Cola Company to investigate where to locate additional plants.

The Ministry of Light Industry also proposed that Coca-Cola establish a concentrate plant in Shanghai as a means for Coca-Cola to broaden its contribution to and participation in the Chinese economy. Chen Muhua, who was then Minister of Foreign Trade, supported this idea. Viewing the plant as a means for China to develop its domestic soft-drink industry, a majority of the members of the Standing Committee of the Party Politburo approved the plan.

Coca-Cola proposed holding 100-percent ownership of the concentrate plant to maintain control over its formula, as is the case throughout the world. In addition, The Coca-Cola Company signed a “contractual joint venture” in which The Company and its Shanghai partner jointly built the nearby bottling plant. While Coca-Cola owned the concentrate plant, the Chinese held ownership in the bottling plant. Altogether, the Shanghai operations worked out to be a 50-50 joint venture. The Chinese partners included the Ministry of Light Industry and the Shanghai Investment and Trust Company (SITCO). President Jiang Zemin (then Mayor of Shanghai) approved the Coca-Cola Shanghai project in 1986. Thirty-five years after one of Coca-Cola's prized plants was closed, a new era had begun.

With plans for a concentrate plant underway in Shanghai and new bottling plants in Shanghai and Tianjin on line, Chinese leaders approved the sale of Coca-Cola's products to Chinese consumers in 1985. Subsequently, in the late 1980s, the market continued to grow. Bottling output grew also as production lines were put in place. In a significant step toward localization, the Shanghai concentrate plant opened in 1988. In 1990, more than 10 years after having reentered the market, The Coca-Cola Company started to make a profit in China.

In 1993, Coca-Cola achieved another major breakthrough. After three months of negotiation, the President of Coca-Cola China, Steve Chan, received approval from the Ministry of Light Industry and the State Economic and Trade Commission for the company to set up ten additional plants in China, adding to the 14 plants already in place and bringing the total to 24. The company planned to build them as quickly as possible, identifying “key” and “anchor” bottlers with which they could collaborate in the target markets. The Chinese approval specified the provinces in which Coca-Cola could set up new bottling plants, and required that the bottling plants be in the capital cities of each of these provinces. The ten new Coca-Cola bottling facilities were to be constructed by the end of 1998. Thus, by the end of the 1990s, Coca-Cola had established a base to sell its flagship brands: Coca-Cola, Diet Coke, Sprite, and Fanta.

The 1993 accord also committed Coca-Cola to developing China’s local brands. The accord directed Coca-Cola bottling plants to produce local Chinese brand soft drinks as well as Coca-Cola products. Actually, this marriage of local and multinational interests began long before the 1993 accord. The Coca-Cola joint venture in Tianjin, established in 1988, produced Chinese brands and Coca-Cola products in the same facility for six years before forming two separate enterprises, each with its own production line: Tianjin Jin Mei (which focused on domestic brands) and Tianjin Coca-Cola Bottling Company (which produced the Coca-Cola brands). At that time, the original bottling facility was transformed into a facility with two missions: manufacturing the beverage base for all non-Coca-Cola brands and providing training for executives in China’s soft-drink industry. A new bottling facility was set up in the Tianjin Economic and Technological Development Zone to handle the bottling of all Coca-Cola brands.

Tianjin Jin Mei spearheads the development of the indigenous non-carbonated beverage brand *Tian Yu Di* (“Heaven and Earth”). In general, carbonated beverages like Coca-Cola, Sprite, and Fanta are market leaders in most Chinese regional markets—accounting for about three-quarters of the overall nonalcoholic beverage sales, with the non-carbonated segment less well developed. The Tianjin joint venture targeted the increasingly popular regional preferences for non-carbonated flavors. *Tian Yu Di* currently makes fruit juice drinks (mango, lychee, and others), ready-to-drink teas (oolong and jasmine), and bottled mineral water. Inaugurated in January 1996, it was the first domestic beverage brand produced in China by a multinational enterprise. In the development of *Tian Yu Di*, Coca-Cola transferred the trademark to the Sino-U.S. joint venture Tianjin Jin Mei Beverage Company. In 1996, the joint venture established the first non-carbonated beverage base plant. By the end of the decade, all bottlers in the Coca-Cola system bottled *Tian Yu Di*.

Another somewhat unusual domestic Chinese beverage line introduced by Coca-Cola and its partner Tianjin Jin Mei is *Xingmu* (“Smart”), a carbonated soft drink line with bright colors and exotic flavors. In 1997, *Xingmu* introduced green apple, watermelon, coconut, peach and orange flavors. These flavors have proved to be extremely successful. Despite its later start, the carbonated *Xingmu* outsells non-carbonated *Tian Yu Di* by approximately four to one. Yet both lines are doing well. *Xingmu* sales surged by 180 percent in the first half of 1999, while *Tian Yu Di* soared by 300 percent.² This level of commitment to developing an indigenous soft drink is remarkable. It is a hallmark of the flexible localization approach that Coca-Cola took in China.

Structure of the Coca-Cola System

Today, to produce locally and extend its global competencies, The Coca-Cola Company works with a select group of bottlers, mostly joint ventures with Chinese state-owned enterprises (Figure 2.1). A subsidiary of the Atlanta-based Coca-Cola Company supplies the beverage-base syrups and concentrate from its Shanghai plant. To make the final product, The Company permits the local bottlers to produce under the Coca-Cola trademark, where bottling companies form franchise arrangements with The Coca-Cola Company. To secure and develop a franchise, a local Coca-Cola bottler must have sufficient capital to invest in the requisite land, building structures, machinery, equipment, trucks, bottles, and crates.

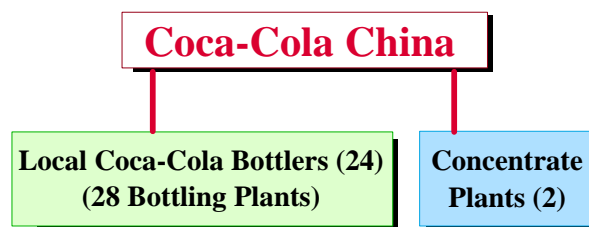


Figure 2.1: The Coca-Cola System in China

By 1999, two decades after reentering the country, Coca-Cola achieved alliances for Chinese bottling facilities in 21 separate cities or provinces. In all, 24 bottling enterprises produce Coca-Cola and Chinese brands. The system encompasses 28 bottling plants. (Some cities have one “enterprise,” but two “bottling plants.”) Five of these plants have been funded with the retained earnings of the existing bottling enterprises. Counting the unique Tianjin Jin Mei venture, which produces beverage base for Chinese brands supported by the Coca-Cola system (discussed later), and the Shanghai concentrate plant, the Coca-Cola system has 30 manufacturing facilities in China.

Table 2.1 and Figure 2.2 depict how the bottling system has spread across the Chinese landscape. As the map suggests, Coca-Cola bottling plants cover much of China, with the notable exception of the western interior provinces. Nevertheless, through the efforts of Chinese distributors the brands can be found in far-inland markets.

Table 2.1: Coca-Cola China Ltd. Bottlers’ Information (as of March 2000)

Name	Year Opened	City/Province	Key Shareholders	Key/Anchor Bottler
Beijing Coca-Cola Beverage Co. Ltd.	1981 (New plant 1999)	Beijing	Kerry Beverages National COFCO Beijing COFCO	Kerry
Swire Guangdong Coca-Cola Ltd.	1983 (New plant 1999)	Guangdong	Swire Coca-Cola HK Ltd. Guangdong Foodstuffs Imp & Export (Group) Corporation COFCO Industries Development Co.	Swire
Guangmei Foods Co. Ltd.	1984	Guangdong (for Xingmu & Meijin)	BFC International (Asia) Ltd. Guangzhou Eagle Coin Enterprise Group Corporation	Swire
Swire Coca-Cola Beverages Xiamen Ltd.	1985 (J/V 1996)	Xiamen, Fujian	Swire Beverages Xiamen Luquan Industrial Co. Ltd.	Swire
Zhuhai Coca-Cola Beverage Co. Ltd.	1985	Zhuhai, Guangdong	Macau Industrial Limitada Zhuhai Food & Beverage Co. Ltd.	Independent
Nanning Coca-Cola Beverage Co. Ltd.	1987 (J/V 1994)	Nanning, Guangxi	Kerry Bottlers (Nanning) Co. Ltd. Nanning Kangle Shareholding Co. Ltd.	Kerry
Dalian Coca-Cola Beverage Co. Ltd.	1987 (J/V 1993)	Dalian, Liaoning	Kerry Beverages Dalian Fruits Co.	Kerry

Name	Year Opened	City/Province	Key Shareholders	Key/Anchor Bottler
Shanghai Shen-Mei Beverage & Foods Co. Ltd.	1987 (New plant 1998)	Shanghai	Coca-Cola China Ltd. National COFCO Shanghai SITICO & Shanghai Food Industrial Investment	Independent
Nanjing BC Foods Co. Ltd.	1989	Nanjing, Jiangsu	BCD National COFCO Nanjing Perfumery Factories	Swire
Hangzhou BC Foods Co. Ltd.	1989	Hangzhou, Zhejiang	BC Development Co. Ltd. National COFCO Hangzhou Tea Factory	Swire
Tianjin Jin Mei Beverage Co. Ltd.	1990	Tianjin, Hebei	Coca-Cola (Asia) Holdings Ltd. Tianjin Beverage Factory China National Food Industry Corporation China Light Industrial Corp for Foreign Economic & Technical Cooperation	Independent
Hainan Coca-Cola Beverage Co. Ltd.	1991	Hainan	Coca-Cola China Ltd. National COFCO Hainan COFCO	Independent
Tianjin Coca-Cola Bottling Co. Ltd.	1994	Tianjin, Hebei	Coca-Cola (Asia) Holdings Tianjin Beverages Factory China National Food Industry Corporation	Independent
Xian BC Hans Foods Co. Ltd.	1995	Xian, Shaanxi	BCD Xian Hans Brewery	Swire
Wuhan Coca-Cola Beverage Co. Ltd.	1995	Wuhan, Hubei	Kerry Beverage National COFCO Wuhan Second Beverage Factory	Kerry
Shenyang Coca-Cola Beverage Co. Ltd.	1995	Shenyang, Liaoning	Kerry Beverages Ba Wangshi Beverage Beijing COFCO	Kerry
Harbin Coca-Cola Beverage Co. Ltd.	1996	Harbin, Heilongjiang	Kerry Beverages Harbin Economic & Technology Area Industrial Development Co. Ltd. Beijing COFCO	Kerry
Swire Coca-Cola Beverages Zhengzhou Ltd.	1996	Zhengzhou, Henan	BCD, Beijing Beijing Zhong Yin Industrial & Trading Co. Zhengzhou General Food Products Factory	Swire
Qingdao Coca-Cola Beverage Co. Ltd.	1997	Qingdao, Shandong	Kerry Beverages Qingdao Yiqing Industrial Corp.	Kerry
Swire Coca-Cola Beverages Hefei Ltd.	1997	Hefei, Anhui	BCD CITIC Anhui Jiushi Group	Swire
Swire Beverages (Dongguan) Ltd.	1997	Dongguan, Guangdong	Swire Coca-Cola HK Ltd. Dongguan Huaxin Industrial Co.	Swire
Taiyuan Coca-Cola Beverage Co. Ltd.	1998	Taiyuan, Shanxi	Kerry Beverages National COFCO Xishan Coal & Electricity (Group) Co. Ltd.	Kerry
Chengdu Coca-Cola Beverage Co. Ltd.	1999	Chengdu, Sichuan	Kerry Beverages Chengdu Hua Jin Group	Kerry
Kunming Coca-Cola Beverage Co. Ltd.	2000	Kunming, Yunnan	Kerry Beverages COFCO Hong Kong Yuan Tong Investment Co. Ltd.	Kerry

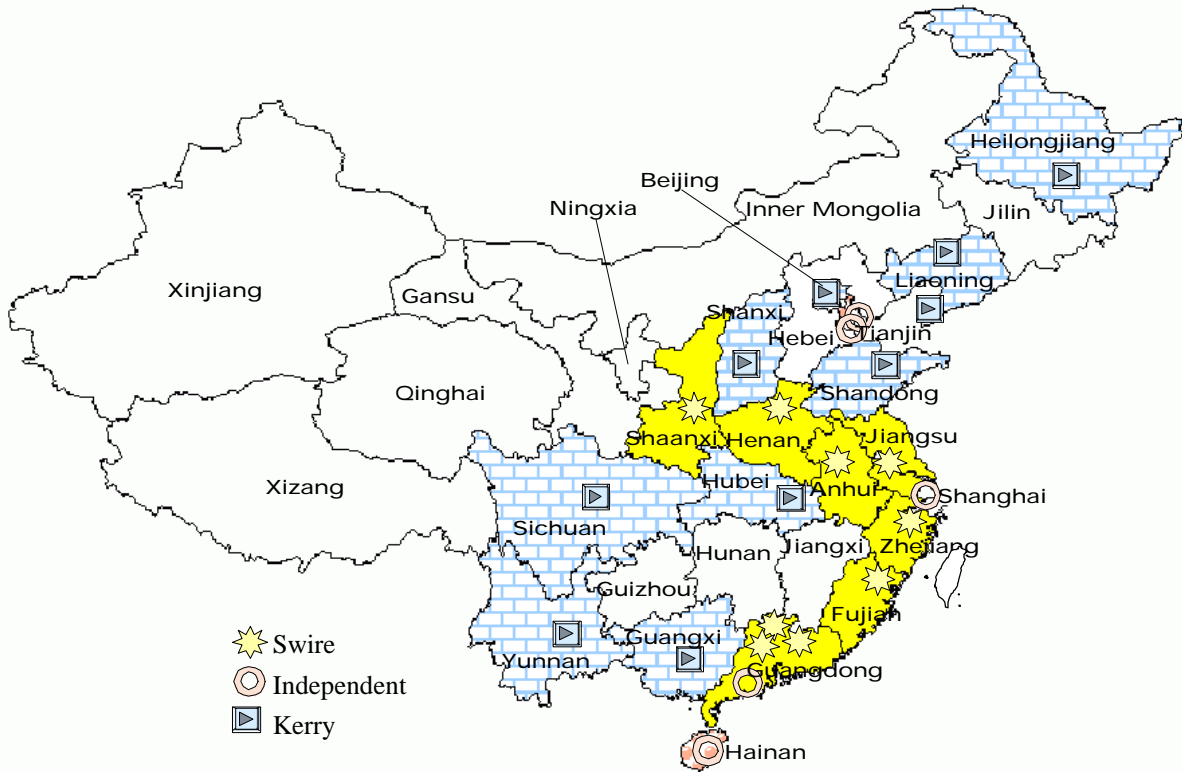


Figure 2.2: Bottler Locations in China (as of March 2000).

Bottling Alliances

Changing bottler relationships form part of the dynamic of Coca-Cola as a multi-local system (see Figure 2.3). Over time, Coca-Cola began to set up joint-venture bottling plants in which it had local partners. These were generally drawn from 3 different Chinese government agencies: the China National Council of Light Industry (NCOLI) (formerly the Ministry of Light Industry, now known as the State Light Industry Bureau, reporting to the State Economic and Trade Commission); China National Cereals, Oils, and Foodstuffs Import and Export Corporation (COFCO); and China International Trust and Investment Corporation (CITIC).³ In most cases, the joint ventures included additional local partners based in the city in which the joint venture is located. The ownership structure of each joint venture is distinct; the local partners put a unique stamp on the business.

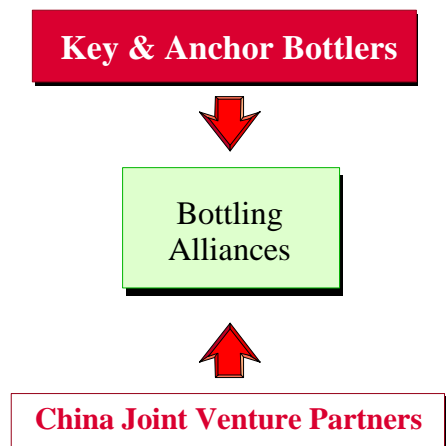


Figure 2.3: The Coca-Cola Bottling Alliance in China.

Following the 1993 accord between Coca-Cola and the Chinese government, Coca-Cola decided to restructure its China operations to involve other key and anchor bottlers as well. The Company placed a priority on consolidating operations into an efficient regional group, as it has done in many parts of the world. The key and anchor bottlers are part of Coca-Cola's bottling realignment strategy, typically consolidating a disjointed bottling system into an efficient regional group. One unusual feature of the Chinese system is the large market area (in both geography and population) served by each bottling plant. Many single facilities are situated in market areas with a population ranging from 40 to 100 million—as large as medium-sized countries. Outside China, many bottling plants would normally cover areas of this size.

Covering distinct regions within a given country, key and anchor bottler advantages include economies of scale and the ability to develop advanced distribution systems. The key and anchor bottlers, in which Coca-Cola typically holds a minority interest, lead Coca-Cola's efforts to reach Chinese consumers. In China, The Coca-Cola Company is allied with two primary multinational anchor/key partners: Swire Pacific and the Kerry Group.

Swire: Southern and Interior China

In 1993, Coca-Cola signed a territorial arrangement with Hong Kong-based Swire Pacific (“Swire”) to produce and distribute Coca-Cola products in southern China and in selected interior provinces. Swire and The Coca-Cola Company are now partners in nine joint ventures in China. The Coca-Cola Company holds a 12.5 percent share of Swire. Swire itself started in the 1960s from Hong Kong as Swire Bottlers. Coca-Cola's relationship with Swire has since extended to include bottling operations in the United States, Taiwan, and China.

With new bottling lines permitted under the 1993 accord, Swire invested heavily. Many of the new investments were in China's interior provinces. Swire's first investment was in the Xian Coca-Cola bottling plant, which opened in 1995. Xian, in Shaanxi Province, is a popular tourist destination, known for its ancient terracotta warriors. To serve this market, Swire entered into a joint venture with BC Development and Xian Hans Brewery to form Xian BC Hans Foods, Ltd. BC Development itself is a joint venture between China International Trust and Investment Corporation, Swire Pacific, and a subsidiary of The Coca-Cola Company. The joint venture distributes the product both to tourists and the 30 million people of Shaanxi province.

Reaching the Top of the World: Coca-Cola in Tibet

Cold drinks find their way to some of the world's coldest places: Coca-Cola brands have been sighted in Tibet (Xizang), although there is no bottling plant for 1,000 miles (the nearest are in Chengdu and Kunming). The products found in Tibet came from Qinghai and Xinjiang, reaching these provinces from Beijing. Other Coca-Cola products in Tibet have originated in Chengdu or Wuhan. Sometimes Chinese entrepreneurs, acting on their own initiative, distribute these products in unusual ways. Bottles or cans are even carried in by camel. Unfortunately, at first some of the cans burst on the camel caravan to Tibet. Upon investigation, it was found that the reason was not the cold weather, but that the cans had been taken from their packaging and put individually into camel packs. Without the protective packaging, the cans were knocking around inside the pack, causing their shells to weaken or crack from stress. The problem was corrected, and camels still can be spotted with Coca-Cola en route to Tibet.

Over the next 6 years, Swire made additional investments in bottling facilities in Guangdong, Fujian, Zhejiang, Jiangsu, Anhui, and Henan provinces. Swire also was allowed to sell

Coca-Cola products in three provinces without bottling facilities: Gansu, Ningxia, and Jiangxi. Altogether, its facilities and distribution network cover nearly half of China and reach a population of 420 million.

Kerry: Northern and Interior China

As Coca-Cola was implementing its anchor bottling alliance with Swire, it was simultaneously forming a key bottling alliance with the Hong Kong-based Kerry Beverages group, led by Malaysian Chinese entrepreneur Robert Kuok. In July 1993, Coca-Cola purchased a 12.5-percent interest in Kerry Bottling. Kerry and Coca-Cola are now partners in ten joint ventures, principally in North China. The Kerry Group is now the key bottler in Coca-Cola's bottling facilities in Beijing, Chengdu, Dalian, Harbin, Kunming, Nanning, Qingdao, Shenyang, Taiyuan, and Wuhan. By the end of 1999, Kerry bottling facilities and its distribution network covered provinces and municipalities with a combined population of nearly 500 million.

Independent Partners

Five bottlers remain outside the anchor/key bottling system: Zhuhai, Shanghai, Tianjin (2), and Hainan. The bottling plant in Zhuhai, a port city near Hong Kong and Macau, is wholly Chinese-owned, the only plant with this status. The Coca-Cola Company and its Chinese joint-venture partners own the Shanghai, Tianjin, and Hainan plants that are outside the anchor/key bottling system.

In Shanghai, a joint venture known as Shanghai Shenmei Beverage and Foods Co., Ltd., owns two bottling facilities (one opened in 1987 and the other opened in 1998). In addition, there is a wholly foreign-owned factory producing Coca-Cola concentrate and beverage bases for the entire country as well as for export to Hong Kong, Macau, and some Southeast Asian countries.

Tianjin has two independent bottling facilities. The unique Tianjin Jin Mei venture was mentioned earlier regarding its pioneering role in developing the indigenous beverage industry. Tianjin Jin Mei is a 50-50-equity joint venture between The Coca-Cola Company and the State Light Industry Bureau of the State Economic and Trade Commission. Tianjin Jin Mei has seen considerable success with the indigenous *Tian Yu Di* ("Heaven and Earth") brand of fruit juice, teas, and mineral water. Recall that the Tianjin facility includes the entire beverage base plant for *Tian Yu Di* (sold by all 24 Coca-Cola bottlers in China) and a national training center for the soft-drink industry, as well as a bottling line. In addition, Tianjin also is home to the Tianjin Coca-Cola Bottling Co., Ltd., which has bottled Coca-Cola brands since its formation in 1994.

The fifth independent partner is in Hainan. Along with its joint venture partners, the national office of the China National Cereals, Oils and Foodstuffs Corporation (COFCO) and the Hainan branch of COFCO, Coca-Cola opened its bottling enterprise in Hainan in 1991.

Over the next five years, the Coca-Cola system in China will encompass additional independent bottlers (i.e., outside the Swire/Kerry anchor and key bottler network). In April 2000, The Coca-Cola Company and the China National Cereals, Oils, & Foodstuffs Import & Export Corporation (COFCO) signed a joint venture agreement establishing the first Chinese majority-

owned bottling operation in the Coca-Cola China system. The joint venture, which will be known as COFCO Coca-Cola Beverages, Ltd., plans to invest \$150 million in China over the next five years. COFCO will hold a 65 percent stake in the new venture, with The Coca-Cola Company holding the remaining 35 percent stake.

Upstream and Downstream Networks

Beyond the bottling alliances is a network of businesses that extend upstream and downstream. To manufacture and distribute soft drinks, the bottlers and the Coca-Cola country office carry out a process of localization with suppliers and vendors. Figure 2.4 shows the Coca-Cola system and its surrounding network. The Coca-Cola network can be seen as different elements in the value chain from agriculture (upstream) to retail (downstream), from sugar refiners (upstream) to street vendors (downstream).

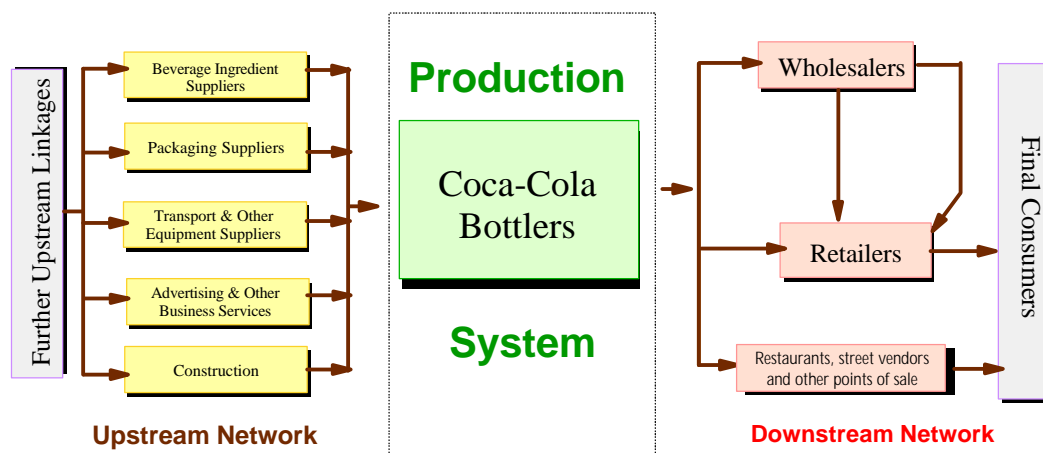


Figure 2.4: Coca-Cola Production and Distribution.

The Upstream Network

In the upstream network, the bottling system connects the local production joint ventures to Chinese suppliers. Local inputs account for 98 percent of the final product. The upstream supplier network, shown in Figure 2.4 embraces dozens of businesses that directly supply inputs and services to the system. The actual soft-drink production process is capital intensive, with highly automated production lines. However, to make the final product, the lines combine concentrate and syrups with other inputs—water, sugar, CO₂, bottling, and packaging material—that require substantial amounts of local labor, both skilled and unskilled.

Each bottler has its own procurement pattern, but the input standards are rigorously enforced. For packaging, Chinese factories, many of them reformed SOEs, supply the polyethylene terephthalate (PET) bottles, glass, paper, closures, and crowns. Chinese producers also supply equipment such as bottling line machinery, trucks, and lifting machinery. Business services include financial institutions, advertising agencies, sign makers, design firms, business consultants, accounting firms, law offices, repair services, and hotel and travel companies. Construction firms are major partners during expansion programs.

The Coca-Cola Company holds no ownership shares in the upstream network. Even so, the Coca-Cola system is a major purchaser for many of the suppliers, so strong relations are built. Close supplier relations in the system generate cost savings—economies of scale, joint production planning, and inventory control—for the suppliers and the bottlers.

Coca-Cola's specifications are demanding, but China has proven to have the capability for advanced, competitive manufacturing and service operations. Many supplies are delivered on a just-in-time basis. Coca-Cola bottlers select suppliers according to their ability to deliver products on demand.

The high degree of localization shows how far the economy itself has been transformed since the liberalization of the late 1970s. In the early 1980s, Coca-Cola was unable to locate suppliers that met the standards required by the bottling system. Initially, some of Coca-Cola's inputs were imported. At the same time Coca-Cola provided free advice on how to raise the quality of products in China, and suppliers quickly rose to meet the standards. A successful example of an upstream supply linkage is Zhuhai's PET. In the mid-1980s, all PET bottles had to be imported. Local enterprises began supplying Coca-Cola's bottling plants as they spread across the provinces. Additional examples are given in Chapter 4.

The Downstream Network

On the distribution side (see Figure 2.4), Coca-Cola has built an extensive downstream network—an infrastructure that reaches from the coastal provinces into the interior regions. Arguably, Coca-Cola is the international-local business system with the greatest commitment to the vast population of China that resides outside of the major cities. The downstream network is responsible for delivering the product of all bottlers to consumers.

The bottling system distributes some Coca-Cola products directly to retailers, but most of the output from the plants first flows through wholesale channels, which then distribute products to local retailers and other outlets outside the major cities served by bottling plants. Based on a survey of bottlers in the Coca-Cola system conducted during 1999 (described in Chapter 3), wholesale comprised 60 percent of total turnover in 1998. Formal retail accounted for 19 percent of turnover; informal retail accounted for 4 percent.

Besides bottling plants, the Coca-Cola system includes warehouses and sales depots in 200 cities—virtually all of the cities in China with a population greater than one million. Distribution will gradually expand its coverage to cities with 500,000 to one million residents. In addition, the Coca-Cola system uses state-owned companies and other distributors to get its product to final consumers. Coca-Cola has a cooperative relationship with wholesalers, but traditionally has not set up joint ventures in distribution. The wholesalers are independent and may handle products other than Coca-Cola (water, candy, biscuits, and so forth).

The Swire and Kerry enterprise groups run sales centers and hire local Chinese for the sales/delivery team. The Swire group oversees 100 sales centers (of the 200 warehouses and sales centers that currently comprise the Coca-Cola system's distribution system). The Hangzhou

area alone has 32 sales centers; the Guangzhou area has 12. Sales centers handle selling, order taking, delivery, and bill collection. They prepare monthly reports on finances, which are sent to the bottling plant for tracking and to the Hong Kong office for consolidation.

In China, one of the unique characteristics of the overall Coca-Cola network is that a large proportion of the distribution is handled through wholesalers, rather than directly. Formal retail outlets comprise a surprisingly small share of all sales. Retailers appear in different forms, from large supermarket chains to small points-of-sale like kiosks and street vending. Distribution in China also must accommodate the reality of China's vast geographic expanse and poor road infrastructure. Distribution in China is extremely labor-intensive when compared to a more developed or geographically smaller country.

Coca-Cola's involvement in distribution to retailers, while a small share of total product delivered, has grown in recent years. Foreign investors like Coca-Cola can now market the products produced in China directly to Chinese retailers. The specific characteristics of Coca-Cola's distribution system are explored in Chapter 4.

Conclusion

The Coca-Cola system has invested more than one billion dollars in China over the past 20 years. Through the large investment program by the anchor and key bottlers and assistance of joint-venture partners, Coca-Cola products are available to nearly 80 percent of China's population. Coca-Cola brands, including Sprite and Fanta, now account for about 30 percent of the carbonated soft-drink market in China.

In this chapter's review of the Coca-Cola system in China—its history and current structure—five essential points stand out:

1. The entire beverage market has grown tremendously since opening to foreign investment in the late 1970s.
2. The Coca-Cola Company is committed to developing an indigenous Chinese beverage base.
3. The Coca-Cola system is a complex array of international-local alliances, including participation by state-owned enterprises.
4. Expansion in Coca-Cola's bottling and distribution facilities in China has stimulated growth and geographic expansion of suppliers to Coca-Cola, including state-owned enterprises.
5. The vast majority of Coca-Cola's distribution is handled through Chinese wholesalers, rather than directly to retailers and other points-of-sale.

The first point suggests that Coca-Cola's business has not achieved its success at the expense of domestic beverage development. Overall soft-drink output has grown 36 times since 1980, an annual increase of 24 percent during the 17 years up to 1997. Carbonated and non-carbonated beverages exhibit a relatively high income elasticity of demand; hence, this growth is not surprising as income levels grew rapidly during this period. Coca-Cola's business has expanded along with the market as a whole. Coca-Cola's leadership role in beverage production, convenience packaging, and marketing spurred increased demand for beverages. Local soft-drink firms have adopted many of the marketing advances of the Coca-Cola system. Even so, the size of the regional markets in China is huge and presents ample opportunity for development by

Coca-Cola and other brands. The market is far from mature: Per capita consumption of Coca-Cola products nationwide is only about 7 servings per year, compared with Thailand at 47.

The remaining points allude to the unique characteristics of the Coca-Cola system in China. The agreement to develop local brands through the Tianjin Jin Mei joint venture is an example of the innovative approach Coca-Cola has taken in China. The singular nature of the Coca-Cola system in China can also be seen in the complex array of international-local bottling alliances, which includes participation by state-owned enterprises. The network of state-owned businesses extends to key suppliers. The country's distribution system, on the other hand, places special challenges on the development of the business. Success will depend on continued innovation in distribution.

Overall, this chapter covered the long history and complex business of Coca-Cola in China. The bottling system is the core, creating upstream linkages with soft-drink input and service suppliers and downstream linkages with distributors, wholesalers, and retailers. The system is large enough to have a palpable impact on Chinese employment and output.

The next chapter presents the direct and indirect impacts of Coca-Cola operations on the Chinese economy. Since Coca-Cola connects with many sectors of the economy, the total jobs and income effects must be calculated using a model that accounts for all the economic interactions in the country. The general impact model employed in this research is an input-output model. Chapter 3 describes the input-output approach, along with precise employment, fiscal, and output impacts.

¹ Pendergrast (1993).

² *The Economist* Intelligence Unit. "Case Study: Coca-Cola Develops Local Brands," *China Hand*, Chapter 8: Consumer Marketing, p. 33.

³ There are four Coca-Cola joint ventures that are not part of the key and anchor bottling systems. Also outside the key and anchor bottling systems is one wholly Chinese-owned bottling company.