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b2b partnerships in the CARBONATED soft drink industry

Jyoti Kainth, Kannan TS, and Vinayak Drave wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On February 7, 2017, the *Utopian Business Times* newspaper broke news of the termination of long-standing contracts between local bottling companies (bottlers) and the owners of two major carbonated soft drink (CSD) brands: Carbon Cola Limited (Carbon Cola) and Thunder Cola Limited (Thunder Cola). In the *Utopian Business Times* article Christina Seth, strategy head of Carbon Cola, further explained:

Carbon Cola has terminated the long-term contract that we had with the local bottler in Utopia. Consequently, we invite prospective bottlers to initiate discussions on entering into a new contract with us. Generally, we enter into long-term bottling contracts and consider them as B2B [business-to-business][[1]](#footnote-1) partnerships. However, considering the current scenario, we are looking at entering into a one-year contract, which can be extended upon mutual consent.

The contract dissolution created turbulence in the CSD industry in Utopia,[[2]](#footnote-2) and raised concerns among the value chain players in that industry. Negotiations for new contracts between the value chain players—which would involve decisions regarding volume of production, marketing budgets, and retail discounts—needed to be finalized before May 30, the start of the peak season for the CSD industry in Utopia. The peak season’s imminent arrival put the CSD brand owners in a difficult position, giving them only limited time to enter into new contracts. However, this was a great opportunity for prospective bottlers looking to enter the CSD market, as they could now initiate discussions with the previously locked-in CSD brand owners and existing retailers.

The Challenge

To stabilize the CSD industry value chain in Utopia, you, as a team, will take on the role of either a CSD brand owner, a CSD bottler, or a CSD retailer, as assigned by the instructor. Based on the information provided in this document and the specific, confidential information provided in your role sheet (to be distributed separately by the instructor), your team will attempt to enter into contracts with the goal of establishing profitable B2B partnerships both upstream and downstream in the value chain.

The two CSD brand owners in Utopia decided the maximum retail price (MRP) of the product, and both CSD brands in the market used the same product packaging, i.e., one-litre plastic bottles.[[3]](#footnote-3) The shelf life of the CSD was six months from the date of manufacture. Retailers could not sell the product for more than the MRP, but could offer discounts and launch in-store promotion schemes. Retailers needed to assign shelf space to the two CSD brands. The total shelf space visibility was indexed as 10 units, i.e., the retailer’s shelf space could accommodate 10 units of CSDs, and the retailer needed to assign and divide that shelf space between both CSD brands. There was no difference between the different units in terms of visibility—the top racks and bottom racks could both equally attract the customer’s attention.

The objective of every team is to increase revenue and profits. Teams are required to negotiate the terms and conditions of the contract with their suppliers and buyers, keeping in mind that profits can be realized by increasing the number of units sold and/or by increasing the margin per unit on the number of units sold. To ensure that all teams have a fair chance to compete, a budget has been allocated to each team that cannot be exceeded. Teams cannot take out a loan. There are no taxes in Utopia, making the net profit equal to the gross profit.

To decide on and evaluate the terms of the contract, each team should consider various factors that affect sales, such as the marketing expenditure incurred by the CSD brand owners, the price of the product, and the product’s availability and visibility.

Rules and Expectations

* Since this is a time-bound exercise, all teams need to act swiftly (as per the schedule determined by the instructor).
* Teams may use only the information shared with them for strategic planning and action; use of the Internet or any external medium of communication is prohibited during the classroom exercise.
* Decisions may be agreed on only after due discussion and consensus among all team members.
* Teams may enter into negotiations with only their immediate value chain partner. Thus, the CSD brand owners and CSD retailers may interact only with the bottlers, while the bottlers can negotiate with both the CSD brand owners and the retailers. Bypassing the value chain is strictly prohibited.
* Cartel formation and/or anti-competitive associations are strictly prohibited. The instructor shall enforce this ruling by overseeing both inter- and intra-team interactions.
* Transactions will be considered valid only when both negotiating parties have filled out, signed, and submitted to the instructor the “Negotiation Template” (distributed by instructor).

Once negotiations are complete, each team will present its strategy as implemented in the negotiation exercise. The presentation will be followed by a brief question-and-answer session.

global SOFT DRINK Industry Overview

The global soft drink industry produced CSDs, fruit juices, bottled water, probiotics, sports drinks, and functional drinks such as energy drinks and ready-to-drink teas and coffee. The industry was projected to grow from approximately US$160 billion[[4]](#footnote-4) in 2008 to approximately $190 billion by 2020. Growth in the sub-categories of the soft drink industry could be attributed to growing health consciousness among consumers. The CSD industry had two key manufacturing processes: making the flavouring syrup and concentrate; and making soft drinks.

*Flavouring syrup and concentrate manufacturing*: The brand owners tightly controlled this process, as the formula was key to their competitive advantage. In addition to the brand flavours, syrup manufacturers also offered generic syrups that could be used by large retailers to make their own private brand.

*Soft drink manufacturing*: This sector contained nearly 10 times the number of companies in the flavouring syrup and concentrate-manufacturing sectors. Companies blended ingredients such as water, liquid beverage bases/syrup, and sweeteners to manufacture soft drinks. They also packaged and distributed these soft drinks for sale. (This sector excluded companies that only manufactured or only distributed soft drinks.) The demand determinants of this industry were price (as price increased, the quantity demanded decreased with high elasticity), income (as income decreased, the quantity demanded decreased with high elasticity), consumer lifestyles, and changing consumer preferences.

Demand for syrup depended on the demand for soft drinks, creating a high positive correlation between the two manufacturing sectors. However, the flavouring syrup and concentrate manufacturing sector fared relatively better than the soft drink manufacturing sector in terms of profitability, possibly because of the strong brand presence of the Coca-Cola Company (Coca-Cola) and PepsiCo, which gave the flavouring syrup and concentrate manufacturing sector an opportunity to pass along increases in input costs and to command higher margins.

Coca-Cola became the manufacturer, distributor, and marketer of its soft drink concentrates and syrups. Before 2010, Coca-Cola sold its syrups and concentrates to contracted independent bottlers who would then produce, bottle, and distribute the final soft drink product. In 2010, Coca-Cola bought out its ownership, and eventually had a dedicated contracted bottler and controlled over 90 per cent of its sales volume.[[5]](#footnote-5)

csd industry

CSDs represented the largest category in the soft drink industry, and many considered CSD production to be an industry in itself, with approximately $71 billion in annual sales in 2013. However, per capita consumption of CSDs decreased by 23 per cent between 2003 and 2013 because of growing health consciousness among consumers, while, during the same period, the bottled water category saw a 105 per cent increase in per capita consumption. The decline in CSDs was expected to continue, with a projected five-year compound annual growth rate of −3.1 per cent. However, it was possible that the soft drink industry could offset this negative growth because of the projected increase in per capita consumption of its “healthy” alternatives.

Operating Model of Bottled CSDs

The syrup manufacturer blended raw materials (i.e., flavourings, syrup, and sweetener), which constituted 6–12 per cent of the soft drink, to form syrup concentrate for a specific CSD. The mixing formulae of the major brands’ syrups were kept confidential.

The bottler incorporated the sweetener into the syrup that was supplied from the soft drink brand owner and mixed the ingredients together in batch tanks. Distilled water was then added to the mix, which was then carbonated. The mixture containers were immediately sealed with pressure-resistant closures (i.e., tin plate or steel crowns with corrugated edges) and packaged according to quantity requirements into containers of pre-specified sizes (e.g., 12-can boxes or six bottles joined with rings or in cartons) for resale to distributors and merchants. Distributors could choose to repackage the product according to demand.

The bottler could ship the consignment to either the merchant, the distributor (who supplied to the merchant), or directly to the final consumer (see Exhibit 1).

THE carbonated soft drink industry in utopia for thIS Exercise

In Utopia, there were two major CSD brand owners: Carbon Cola and Thunder Cola. Their only products were CSDs, and these products were identical in all aspects (e.g., taste and quality). For the past five years, the CSD brand owners had an almost equal market share and were in direct competition with each other. The brand owners outsourced the manufacturing and distribution of the CSDs to bottlers who operated as their franchisees. The brand owners would receive the key flavour ingredients from their trusted syrup and concentrate manufacturers, and then pass them on to the bottlers. However, in January 2017, both Carbon Cola and Thunder Cola terminated their long-standing bottling contracts on the grounds of non-adherence to contractually agreed-upon quality standards.

Both CSD brand owners were looking to enter into one-year contracts with new bottlers. This situation presented a great opportunity for two prospective entrant bottlers: Electra Beverages Limited and Drinko Beverages Limited. The bottlers and CSD brand owners were expected to negotiate exclusive partnerships. If Electra Beverages Limited and Drinko Beverages Limited could win the bottling contracts with the CSD brand owners, they would have manufacturing and distributing rights to the CSDs as dedicated bottlers for the period of the contract. For ease of calculations, approximately one litre of syrup was required to make one litre of the final product—i.e., the CSD. The final players in the value chain process were the retailers. There were three retailers in Utopia: FarMore Retail Limited, GreatDepot Retail Limited, and HomeMart Retail Limited.

In 2016, the CSD industry in Utopia had a total turnover of $45 billion (see Exhibit 2). The industry was expected to grow by 4–5 per cent in 2017, depending on the marketing expenses incurred by the CSD brand owners and the average selling price of the CSDs.

EXHIBIT 1: OPERATING MODEL OF BOTTLED CARBONATED SOFT DRINKS

Source: Created by the case authors.

Exhibit 2: PERFORMANCE Values from the 2016 Carbonated Soft Drink SECTOR Reports

|  |  |
| --- | --- |
| Total Sales in Utopia (Value) | $45 billion |
| Total Volume Sold (in Litres) | 5 billion |
| Market Share of Carbon Cola | 50% |
| Market Share of Thunder Cola | 50% |
| Expected Growth Rate | 5% (Volume Terms) |

Source: Created by the case authors.

1. B2B referred to transactions between businesses/companies, rather than between a company and the final consumers. A B2B partnership could involve a manufacturer and a wholesaler or a wholesaler and a retailer. Strong B2B partnerships were the result of a mutual understanding among various businesses as they helped each other achieve profitable growth. [↑](#footnote-ref-1)
2. Utopia was an imaginary place where people consumed CSDs on a regular basis. [↑](#footnote-ref-2)
3. The one-litre plastic bottles were made from polyethylene terephthalate commonly known as PET, which could be recycled and was widely used as packaging solution for carbonated beverages. [↑](#footnote-ref-3)
4. 4 All currency amounts are in U.S. dollars unless otherwise specified. [↑](#footnote-ref-4)
5. Nicole Fry and Hana Kim, *The Evolving Non-Alcoholic Beverage Landscape* (Los Angeles, CA: First Beverage Group, March 2015), accessed June 19, 2017, www.firstbev.com/wordpress/wp-content/uploads/2015/03/FBG\_Non-Alc-White-Paper\_March-2015.pdf. [↑](#footnote-ref-5)