

# COKE GETS A JOLT

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The soft drink giant has done business the same way for 120 years. Now CEO Neville Isdell wants it to face the future.

EVERY YEAR, Coca-Cola holds its annual shareholders' meeting not in its headquarters city, Atlanta, but in its place of incorporation, quiet Wilmington, Del., in the Hotel du Pont, built by the industrialist at the turn of the last century--a century, one supposes, that Coke prefers to the current one. Change doesn't come easily to this company. Even the faces at this annual meeting haven't changed much through the decades. The board is a tight-knit group of 11 people whose average age is 67. Seven have served Coke for 20 years or more. Back when Roberto C. Goizueta was CEO, he used to joke that he told the company's pilot to keep the jet engines running, so perfunctory were the annual meetings.

This year's meeting, though, marked a turning point. Warren Buffett, 75, was gone, having announced in February that he would leave the board after 17 years to spend more time on Berkshire Hathaway. Donald Keough, 79, the legendary former COO, was still there as a director, but the crowd he faced was altogether different from the complacent gatherings of years past. The audience of roughly 400 people was an odd assemblage of simmering college students, angry water-rights activists, angrier labor-rights activists, dismayed employees, watchful plainclothes security, and white-haired shareholders bewildered by their stock's 52% plunge from its high of \$88 in 1998. CEO Neville Isdell has known for a long time that Coke must change if it is to prosper again, and he chose this moment to drive that point home.

"Next month the Coca-Cola Co. will celebrate its 120th anniversary--120 years since someone paid a nickel for Doc Pemberton's inspiration-in-a-glass at Jacobs Pharmacy," Isdell told his audience. "Today consumers invite us into their lives more than a billion times a day for enjoyment, fun, and refreshment. We understand, however, that what has sustained us these first 12 decades will not be sufficient for the future."

When Isdell came out of retirement two years ago to take over at Coke, he inherited a company that had utterly lost faith in itself, governed by a board that could not leave it alone. A social worker by training, he knew a transition would take two years. During that time he repaired morale. He and his management team set out to understand how Coke's world had changed--analyzing what beverages people drink and why and when they drink them--and to devise a new roadmap called the Manifesto for Growth. Coke would not diversify away from beverages, they decided. Rather, Coke would deliver on its promise to be a nonalcoholic-beverage company with an ever-expanding portfolio to meet consumer needs. That may not sound like much, but for Coke it's what Isdell calls a "revolutionary evolution."

At this annual meeting he declared the transition over. The new Coca-Cola, he promised, will innovate--as it did in the first quarter, launching new products with strange-sounding names like Tab Energy (diet energy drink), Coca-Cola Blak (coffee Coke), and Full Throttle Fury (a citrus-flavored energy concoction). "You'll see better marketing and stronger connections with

consumers," he told the audience. Coke, he said, would be bold: It upped its annual base spending on marketing and **innovation** last year by \$400 million. "You will see some failures," Isdell said. "As we take more risks, this is something we must accept as part of the regeneration process."

For too long Coke had stayed stubbornly, defiantly rooted in its past, holding on to the belief that its business model was as good as gold: Make cola concentrate for pennies, then sell it for dollars through a global bottling system to a mass market that still pretty much drank what it saw on TV. When bottled water came along, one director called it a "low-margin road to nowhere." The company was late to the game in sports drinks, energy drinks, and coffee, regarding them as low-volume distractions. Coke's board nixed the acquisition of Gatorade, in what one equity analyst calls a "transformative mistake." (Pepsi got it.) The irony, says analyst Matthew Reilly of Morningstar, is that until just recently, "Coke wasn't even a player in energy drinks--and it was the original energy drink."

That left Coke with one of the world's most powerful brands when big brands are boring. It takes a lot more than Coke With Lime to impress the video iPod generation. They want Izzes and Starbucks and Red Bulls. They want choice, not a company telling them "Father knows best." That came across loud and clear in the annual meeting, as students from Harvard, the University of Pennsylvania, and Carleton University in Ottawa spoke out on matters ranging from labor violence in Colombia to Coke's water use in India to--get this--exclusive contracts on college campuses. "Students are telling us they do not like contracts that make it so that the only beverage they have on campus is Coca-Cola," said a student organizer from Carleton. "Let me tell you, instead of breeding a future generation wanting to drink Coca-Cola, what you are doing is forcing students to move away from Coke."

Coke has been off track for nearly a decade. The unexpected death of CEO Goizueta in October 1997 sent the company into a tailspin. The board meddled, installing two unsuccessful CEOs before Isdell. Politics festered; talent fled or got the boot. The company settled charges of channel stuffing to prop up earnings. Meanwhile Pepsi took off: In the past five years its stock has risen more than a third, to \$58 a share.

In an interview days after the annual meeting, Isdell said, "I don't believe we've done more in the past than dabble outside carbonated soft drinks. We have not been able to think creatively enough" about sodas themselves. "We've often chased volume to the detriment of the business." Now his team is looking at sodas as potential "carriers of health and wellness," searching for new, natural sweeteners, and trying to convince Coke and its bottlers that they can distribute 1,000 brands and packages when they think they can handle only 200.

Wall Street wants to know: Is it bold enough? Compare Coke to Starbucks, a beverage company that has gone into food, music, and entertainment. "Coke has tried to foster a young, hip image," says Reilly, the Morningstar analyst. "They might want to get someone on the board who can hear what's hip from their kids instead of their grandkids."

If Coke isn't bold enough, it may find itself reacting to changes forced upon it by its biggest bottler, CCE, which--just days after the annual meeting--named its first outsider as CEO. Coke created CCE 20 years ago as a publicly traded bottler, retaining a controlling stake (currently 36%), and until now CCE's chief executives have come from Coke or one of its own bottlers. The new boss, John Brock, is certain to have a game plan of his own. He was previously CEO of Inbev, the big brewer; CEO of Dr. Pepper/Seven Up Bottling Group; and COO of Cadbury

Schweppes when it gobbled up Snapple and Nantucket Nectars. He is likely to be fiercely independent in his attempt to build value for his shareholders--and those interests aren't always aligned with Coke's. If Isdell doesn't deliver on Coke's manifesto for growth, Brock may devise his own.

So Coke can't afford to be nearly as controlling or arrogant as it once was--with bottlers, consumers, or shareholders. Isdell says part of his job has been to "lead the board into this regeneration of the Coca-Cola company." Recently the board adopted a new compensation plan: From now on, the directors will get paid stock units valued at \$175,000 for each year the company meets its target of an average annual increase of 8% in EPS over three years (they won't get paid otherwise). Critics dismiss the move as a gesture, and it's going to take a lot more than gestures to make this company thrive in the 21st century. This year will be showtime. If Isdell can produce blockbusters--and especially if he can't--the annual meeting should be even more interesting next year.

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