The Coca-Cola Company, a key producer in the soft drink industry, has achieved remarkable success in the market. For over a century, the firm has experience all kinds of economic fluctuation and consumer taste shifting, but it is able to survive and thrive through them. Its marketing strategies therefore provide great interests to study. This paper is going to explore the marketing model of Coke in the following four aspects: the company’s focus on consumers’ need, its practice of second-degree price discrimination, the mixed bundling method in pricing, and the feasibility of strategic positioning.

The popularity of Diet Coke indeed comes from the excellence of the product itself, but it is the company’s marketing strategy that ultimately leads to the success. In his work *Marketing Myopia*, Theodore Levitt discusses the significance of customer-centered marketing. How does the launch of Diet Coke illustrate Levitt’s theory of avoiding shortsighted management?

The New York Times article *Diet Coke Reflects Changes in Market and the Industry* was published in August 1982, shortly after Diet Coke was brought to market. It talks about the development process that the new product has gone through as well as how it signals changes in the soda industry. Introducing Diet cola is not an overnight flashy idea of Coke. Rather, it had been conceived since the beginning of 1960s, when health campaigns started to sweep the world. Executives of the company learned that nearly 30% of the world population was worried about its weight. They realized immediately that the customers of Coke needed something that both tastes good and averts weight problems. After identifying customers’ needs, Coke decided to
create a value satisfying cola, just as Levitt suggests. In 1982, Diet Coke was introduced as a sugar-free and calorie-free soda and it prevailed in the market rapidly.

Levitt argues that defining the industry broadly is the key to identify customers’ needs, so that firms can continue growing rather than being fatefully obsolete. Coke has always been aware of that it is facing the cola industry, not only a manufacturer of its featured product Coca-Cola. It employs a typical mass production method; for every mass production firm, production pressure matters, because they gain profits by volume. Nevertheless, unlike many other firms who try to sell as many as they can in order to get more profits, Coke focuses on marketing, since keeping customers is truly its secret to success.

The achievement of Coke is legendary, but Coke knows it cannot rest easy here: its market is getting closer to saturation. Although it has exploited oversea markets and it still invests a great amount in it, Coke decides not to rely on population growth. After all, large population does not ensure an industry’s growth. What prevents an industry from declining is the willing to follow customer’s needs and create new products accordingly. Levitt mentions that many industries have failed due their lack of imaginativeness and audacity to make change. Diet Coke was a gamble for the company, but having the courage to invent new products to meet customers’ need is already a success in itself.

Another brilliant marketing strategy of Coke is that it targets men and women separately, so that satisfaction can be created to cover as much of the market as possible. After Diet Coke was launched, it was observed that the new drink attracted mostly women. Nevertheless, statistics from the 1990s had shown that 29% of men were dieting. (Parker-Pope, “Instead of Eating to Diet, They’re Eating to Enjoy”) Coke knew that the feminine image of Diet Coke has driven away a large amount of potential customers. As a result, they came up with Coke Zero in
2005, a cola marketed to men. The black design of Coke Zero package is usually associated with a masculine image. One point to notice is that although the success of Coke Zero and Diet Coke unavoidably erodes the market share of the original Coke, they expands the entire cola market by pulling in more marginal consumers.

In spite of the large market share of Diet Coke, the volume sold is actually experiencing a significant falling, mainly due to consumer’s choice against artificial sweeteners such as aspartame. Facing the same plight of decreased volume, Diet Pepsi has declared to make its formula aspartame-free in order to get customers back. After its major competitor took action, Coke is likely to respond by replacing aspartame as well, and it will require Diet Coke to destroy its old formula. Furthermore, this “creative destruction” can affect the entire soda market as well. When a healthy substitute for sugar is available, how much will consumers still demand sugary sodas?

Diet Coke is the first step that Coke took to cope with the health alert. While diet products are getting more attention in the market, the demand for traditional carbonated drink has been falling. It appears that these ongoing health campaigns are really unfavorable to the Coca-Cola Company, but Coke is actually making more profits by taking advantage of this seemingly adverse situation. What is its secret? The short answer is price discrimination. While lowering unit price for large packaging is already a classic approach that almost all drink producers take, Coca-Cola has started working on the opposite direction to promote small packaging of Coke in order to satisfy consumers’ changing preference due to health concerns.

As discussed in the article *Coca-Cola Profit Up 19%, Despite Lower Sales*, Coca-Cola has succeeded in brings up by price discrimination. In the industry, Coca-Cola has enough market power to impose price discrimination. We must wonder how the existence of PepsiCo
interferes, but let’s focus on Coke first, and we will get to Pepsi later. In addition to market power, incentive to resell can be limited, because the profit that a person can gain from sell a unit of Coke is very low. However, Coke cannot identify each individual buyer’s willingness to pay. Thus, the company is not able to perform first-degree price discrimination, which is a linear pricing method that charges each consumer exactly their willingness to pay.

Does this mean that Coke has to give up price discriminating? Of course not. What the company employs is second-degree price discrimination, a non-linear pricing method. The convention that drink manufacturers apply second-degree price discrimination is reducing unit price if a buyer is to purchase more. Each can in a 6-pack carrier is sold at a lower price than separately. Another way to discriminate is to lower price per ounce for large containers, such as a 20-oz bottle. For this reason, this approach is also called quantity discount. By offering this option to consumers, the producer can get them to reveal the willingness to pay.

One important feature of second-degree price discrimination is that it always comes with two-part tariff. A tariff in this case represents the right to purchase at lower price. For Coca-Cola, the way that the tariff functions is similar to the practice of cell phone companies, who provide monthly plans of different prices depending on how many free call minutes or texts a package includes. A larger bottle of Coke or a pack of six is a tariff in itself: consumers can enjoy lower price only if they buy large packaging, and price for each unit becomes zero once they get it. Under second-degree price discrimination, Coke and its consumers with high demand win, and consumers who demand little lose. The higher the demand is, the more elastic the consumer is, since change in price is more likely to affect their decision of buy or not. In all cases of price discrimination, the party with more demand elasticity always wins, and so does Coke.
In order to reduce calories intake, many people try to limit the amount of Coke that they consume. Coca-Cola seizes this opportunity and comes up with smaller package of Coke such as the 8-oz can. Small package is charged higher average price per unit as well as a lower “fee”. Coke’s attention has been shifted away from customers who pay high “fee” and lower unit price. People who pay more for small packaged Coke have lower demand, because they are also purchasing “less guilty”. In the meanwhile, people who do not care about diet as much would continue pay a lower price, and they are still very sensitive to price change. Although these healthy buyers “lose” consumer surplus by paying more, they are happy with it because they believe health is their more valuable winning, and this is slightly different from our general assumption that people get more utility from consuming more.

All firms try to exploit consumer surplus as much as they can. Pepsi, the other giant in the industry, also attempts to share a slice of pie by marketing smaller can. It seems that the market strategies of the two firms are always synchronous, and the existence of strong competitor does reduce Coke’s market power to discriminate. Who is the ultimate winner of health campaigns, consumers who benefit more from consuming less or cola producers who profits more from selling less?

While smaller containers of Coke are absorbing more profits from the ongoing health campaigns, fountain soda, which is Coke’s another important revenue source, does not get as much from selling smaller cups. The reason is that fast food chains are the largest suppliers of fountain soda, and a great amount of soda sales are tied to meal combos, which includes a given size of cup. How do fountain owners and soda suppliers manage to profit from combining soda to food? Here is the secret — mixed bundling!
The long-lasting partnership between Coke and McDonald’s started in 1955. Since then, Coke has been able to generate great amount of profits through McDonald’s soda fountain. In the early 1990s, McDonald’s brought out Extra Value Meal following Coke’s suggestion. (Gelles, "Coke and McDonald's, Growing Together Since 1955.") The meal includes a burger, a medium size fries, and a medium size fountain drink. This value meal perfectly illustrates the idea of mixed bundling, which is a pricing strategy of providing consumers a choice between buying a bundling and buying goods separately. In order to profit from bundling, conditions on markets power, resale, and consumer’s taste need to be met. McDonald’s has market: it is the No.1 fast food chain and it has monopoly over “McDonald’s burgers.” Consumers do not have much incentive to resell each item in the bundle, because the tiny amount of profit they can get from resale just doesn’t worth the time or effort. Also, consumers’ value of different goods has to be negatively correlated, that is, the more they value A, the less they value B.

For Extra Value Meal, let’s assume a burger/sandwich is one part of the bundle, and regard one bag of fries and one cup of Coke’s drink as a single compound good. Currently, McDonald’s sells a Big Mac (M) at $3.99 and the meal at $5.59. Price of a medium fries is $1.59, and a medium soda $1.29, thus the price for the compound good (S) is 2.88. As shown in the chart below, the only three buyers are a, b, and c who value the two goods differently. Let’s further assume the cost of producing Big Mac is $1.5 and producing the compound good is $1.

<table>
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<tr>
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<th>Big Mac (M)</th>
<th>Fries + Soda (C)</th>
<th>Adding the two</th>
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<tbody>
<tr>
<td>a</td>
<td>$3</td>
<td>$2.69</td>
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<tr>
<td>b</td>
<td>$3</td>
<td>$3</td>
<td>$6</td>
</tr>
<tr>
<td>c</td>
<td>$6</td>
<td>$0.5</td>
<td>$6.5</td>
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<tr>
<td>P</td>
<td>$3.99</td>
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As illustrated in the graph, a is located on the bundle indifference line, and she will buy the bundle. Her values of both M and S are lower than their price, so she will not buy either separately. The consumer surplus (CS = MB - P) she gets from the bundle is 0, and the profit that McDonald’s get is 5.69-(1.5+1) = $3.19. Consumer b will buy the bundle as well, and she will get CS of $0.31. If b buys the bundle, the profit for the restaurant is $3.19 as well. Although also falls to the right of the bundle curve, consumer c will not buy the bundle, because her value of Big Mac is lower than its price in the bundle ($1.7 = $5.69-$3.99). C will buy Big Mac only, and she gets $2.01 of consumer surplus from it. Therefore, McDonald’s can earn profit of $2.49 from c. In total, McDonald’s sells 3 Big Macs and 2 of each soda and fries; the total profit is equal to $8.87.

Now you must wonder what if McDonald’s has no bundle? It looks like both the restaurant and Coke will be much worse off, because consumer a will not buy any, b and c will only purchase one of the two goods. However, it is not as easy as it seems to be at first glance! If bundling does not exist, McDonald’s will lower the price for both M and S so that they can sell more even though the profit of selling each unit decreases.

For a consumer of pure bundling, she has to buy either everything or nothing; there is no such compromise as buying only one of them. When there is no cost of production, firms will be
better off using pure bundling, since they can always get more profit by selling more. However, McDonald’s does have cost to produce the goods: if it wants to catch all three buyer, the price will be reduced to a level that is lower than its production cost, so it is not reasonable to have pure bundling.

McDonald’s is often accused of providing food lack of nutrition or having too many calories. In 2013, McDonald’s stopped promoting soda as part of kids’ Happy Meal due to consumer pressure and regulations. The sale of soda associated with Happy Meal has been falling since then. As a whole, McDonald’s is negatively affected by consumers’ switching to healthy diet, and the restaurant tries to fix it by introducing more healthy food to the menu such as salad and juice, but these actions don’t really help increase the volume of soda sold. Coke and McDonald’s now need a new way to cooperate other than simply bundling themselves together.

While Coke is striving to survive consumers’ changing preference towards healthier diet, the company cannot loose the alertness to what its competitors are doing. As mentioned previously in this paper, Pepsi is also trying new approaches in order to take advantage of consumers’ new taste and generate more profit. After all, the tide of health campaigns is influencing the entire soft drink industry. Thus, it becomes necessary to explore the strategic position of different players within the industry as well as their competitive advantage. Unfortunately, we can’t really do this analysis for the soda industry. What?

Whether a firm can gain positive profit from its production depends on several different factors, such as the industry it is in, the firm’s performance, the economic situation at a given time period, and etc. Firms’ profitability varies a lot across industry. We would not expect that the profitability the profit-generating process is the same for a soda producer and a department store, because market attractiveness differs. Yet even within the same industry, there are always
high performers and low performers. In the soft drink industry, Coke has been known to outperform Pepsi: the return on invested capital is 13.70%, which is much higher than Pepsi’s 4.02%. (Besanko 362) In addition, the global market share of Coke’s soda is more than twice of that of Pepsi.

It comes naturally to attempt employing the idea of competitive advantages to explain the superior performance of Coke, but the fact that different sodas cannot be vertically differentiated hinders the application of the model. Vertical differentiation refers to the situation that everyone can agree on the ranking of different products when price is not involved. For example, an 128GB iPhone is always better than a 16GB one. In contrast, people have different opinions on whether the silver iPhone is better or the gold one is, and this disagreement on quality points to horizontal differentiation. Different taste in color is similar to what the soft drink industry is facing: people have different preference between Coke and Pepsi, and sometimes it is hard for them to differentiate the two! Comparing the competitive advantage of the two firms requires the knowledge of consumers’ preferences over price-quality trade off of a product, but horizontal differentiation does not allow us to determine the quality. As a result, we cannot compare different levels of consumer surplus on a value map, which leaves further analysis unavailable.

Competitive advantage model does not fit the soda industry well, but there has to be some factors that determine the competitiveness of a firm within the industry. The war between Coke and Pepsi is not about price or quality, but brand loyalty. In the WSJ story Why Coke’s Stock Could Find Its Fizz Again, the author mentions that Coke has been cutting cost. For products that can be vertically differentiated, cutting cost is often towards achieving cost advantage, because the firms can now lower price and hence sells more. Nevertheless, Coke does not plan to lower price at all. A great amount of the cost savings are reinvested into the marketing in order to
attract more marginal customers as well as strengthen the enormous brand loyalty that has been the major profit generator of the company.

Throughout the paper, consumers’ health concern is an issue that has been involved in Coke’s decision making. It is true that Coke are facing more threat from this change in preference than many other firms because of its heavy focus on soda production. Will Coke continue getting profit by taking advantage of it, or will it inevitably end declining? Following consumers’ needs will allow it to use more beneficial strategies. If Coke keeps this in mind, the future will be optimistic.
Works Cited


