Coke's Expansion into the Wine Market

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For years, the strategy of diversification has enabled many American companies to grow their businesses dramatically. Executives generally believe that by entering into new markets that are in some way compatible with their current product line (but also different in terms of customer base or other factors), diversification will allow their companies to achieve business synergies, reduce the overall risks of doing businesses, and hedge against change in the future. As desirable as this it, and as plausible as this strategy sounds, many executives have also learned that to pursue value-increasing diversification strategies is much more difficult than an observer might usually think.

The Coca-Cola Company had an unusual experience with diversification. During the company's century-long operations, its core business has been always focused on soft drinks and juices. Today, 77% of the Coca-Cola Company's revenues are from carbonated soft drinks, whereas 23% of the revenues are from non-carbonated soft drinks including fruit juices, waters, sports drinks, and teas. Its top competitor, PepsiCo, has a much more diverse product portfolio, consisting of not just soft drinks but also various snacks and convenience foods. Because they saw PepsiCo expanding into additional markets, at one time, the management at the Coca-Cola Company also thought it might be a time for change.

Until 1977, the Coca-Cola Company had not tried including alcoholic beverages in their product mix. During that year, the company acquired Taylor wines of New York and created a subsidiary called the Wine Spectrum. This subsidiary also included the Monterey Vineyards and Sterling Winery in California. The top management of Coca-Cola thought that the wine business looked like an attractive business at that time; and, if truth be told, the Coke executives enjoyed having lovely wine bottles on the tables at various corporate dinners and parties.

But Coke's entry into the wine business was not as successful as the firm had expected it to be. The firm's top management felt that their investment was not reaping the dividends it should have, despite the fact that Coke excelled in terms of its intimate knowledge of consumers, its marketing and branding expertise, and its superior distribution capabilities. Coke wanted to understand where they had gone wrong.

The person who was able to answer this question was Robert Woodruff, who had retired as the CEO of Coca-Cola after a long and distinguished career there. Woodruff paid a visit to the vineyards at California and observed what it took to be successful in that market. After the trip he had a conversation with then-CEO and President of the Coca-Cola Company, Roberto Goizueta and Donald Keough, and assessed the marked differences between Coke and wines.

According to Mr. Woodruff, vineyard owners reported that it normally takes five or six years for a vine to mature enough before harvesting. After grapes are harvested, the fermentation process requires expensive equipment such as stainless-steel tanks and small casks made of French Oak. The wine then needs to age for quite a while when as much as 15 percent of the wine is lost through evaporation. The wineries must keep the wine in bottles for years before sending them

into retail stores. In the meantime, there are already hundreds of different competitors' wines on the shelves. The Coke business, on the other hand, is a business where you bottle it in the morning and then sell it in the afternoon. There is not much competition in many of the places where Coke is sold. Coca-Cola understood this short-time-frame market very well, and was very successful in it; but they were not comfortable in a market where such a long time frame, and such dedication to product development, were needed.

Thanks to Mr. Woodruff's assessment, the management at the Coca-Cola Company decided to take another look at the wine business. With the help of the managers from the Wine Spectrum, they soon found out that in this business the return on capital would be equal to or less than the cost of capital given the most optimistic conditions. It did not take long before they made a decision in 1983 to sell the subsidiary. They were fortunate to find a buyer for their wine business, Joseph E. Seagram & Sons Inc. from New York. The deal went through nicely for both parties and the Coca-Cola Company received $200 million from Seagram.

Discussion Questions:

1. Why do you think the Coca-Cola Company bought the wine business? Why did they sell it later on?
2. Besides the differences mentioned in the case, can you think of other differences between soft drinks and wines?
3. Why does PepsiCo have a much more diverse product portfolio than the Coca-Cola Company does? What benefits does the diversification strategy have for the company?
4. Was it a mistake for the Coca-Cola Company to buy the wine business? Was there anything they could have done to make the wine business a success for their firm?

Resources:

– Donald R. Keough, The Ten Commandments for Business Failure, 2008, New York: Portfolio.
– http://www.nytimes.com/1983/09/28/business/market-place-coca-cola-without-wine.html
– https://hbr.org/1997/11/to-diversify-or-not-to-diversify