

Explore the Reasons for Coca-Cola's High-profit Margins

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ABSTRACT

This paper explores the reasons for Coca-Cola's high profitability, which have essential enlightenment and reference significance to other companies in the beverage industry. The industry analysis illustrates the current condition of the beverage industry, especially under the adverse impact of the COVID-19. Then the corporate strategy analysis, which concentrates on product, marketing, cost, supply chain strategy and the influence of the strategic acquisitions, is applied to analyze the special and unique process of Coca-Cola company. And the financial analysis, including horizontal analysis and financial ratio analysis, evaluates Coca-Cola's high profitability in quantity through various financial ratios by using the data in the recent three years. Based on the comprehensive analysis focusing on the differences between Coca-Cola and other enterprises from the perspectives of revenue and cost, this paper finally concludes that the reasons for Coca-Cola's exceptionally high profitability are that the company has excellent development strategy to boost revenue and cost control strategy to save costs.

Keywords: Coca-Cola, Beverages, High profitability, Profit margin

1. INTRODUCTION

Soft drinks mainly include nine sub-categories: packaged drinking water, ready-to-drink tea, carbonated drinks, fruit drinks, energy drinks, sports drinks, ready-to-drink coffee, Asian specialty drinks, and concentrated drinks. The 5-year global industry forecast remains largely consistent with initial expectations, albeit with a high degree of uncertainty about on-trade assumptions and 2021 downgrades in some developing countries. Volume growth of 4.5% is expected for FY2021, a 0.2pp downgrade versus the researched baseline[1]. A carbonated beverage is the world's largest segment of the market. Coca-Cola and Pepsi rely on the carbonated beverage market to become the two giants of the global soft drink industry. Among them, Coca-Cola has the largest market share globally, more than twice the second-largest Pepsi, dominating the world.

The Coca-Cola Company (Coca-Cola Company), founded on May 8, 1886, headquartered in Atlanta, Georgia (GA), is the world's largest beverage company, with 48% of the global market share and two of the world's top three beverages (Coca-Cola ranked first, Coca-Cola has 160 beverage brands in 200 countries, including soft drinks, sports drinks, dairy drinks, juices, tea and coffee, and is the world's largest distributor of fruit juice drinks.

Since its establishment, Coca-Cola has continuously occupied the market through market expansion and combination marketing, driving the leading position in the beverage industry. Through the analysis of the relevant financial data of the beverage industry, it is worth noting that Coca-Cola has always maintained a high-profit margin. In detail, although Coca-Cola's operating expense ratio is close to the industry average, its operating profit margin is more than twice the industry average.

Through the analysis of Coca-Cola's business characteristics and business strategy and financial analysis, this paper can conclude that Coca-Cola's high-profit margin is due to its excellent revenue and good cost control effect.

On the one hand, Coca-Cola has adopted various strategies to expand its market share and increase its product sales. Firstly, the unique feature of Coca-Cola's products is its secret recipe. The Coca-Cola recipe and the stories behind this brand have helped Coca-Cola acquire public attention and marketing focus in the marketplace. This unique feature makes Coca-Cola become an irreplaceable brand that any other company can compare. Second, the company has developed a unique marketing strategy according to the market. In terms of advertising design, the company focuses on the spiritual needs of customers, and most of the advertisements designing is based on some meaningful short films or movies, which establishes the emotional resonance between the brand and customers. Also, in terms of product design, the company skillfully combines the products with the characteristics of each regional market. According to the trend and cultural characteristics, the company continuously updated product packaging and product capacity. Thirdly, the company adopts the "1+X" sales model, which sets up bottler partners in major regions responsible for production and sales.

Meanwhile, the company has implemented the "101" sales mode. These customers are responsible for market analysis and order distribution. These sales models have greatly improved the market share and sales volume of the products, making Coca-Cola's products spread worldwide, even in remote areas. Finally, through regular evaluation and acquisition of other brands, Coca-Cola has enriched its product range and brought excellent profits to the company.

On the other hand, Coca-Cola has adopted excellent cost control strategies in production and sales. In the production process, the company has adopted advanced production technology, which can save production and labor costs. In terms of sales, the company has established a complete supply chain management system, which gives the bottler the special right to manufacture and sell the products. The bottlers set up the plants near the concentrate manufacturer's plants, therefore a lot of capital investment and beverage transportation costs can be decreased.

Through reading various reports about beverage industry and companies, it can be clearly seen that most analysis about these companies uses some well-known frameworks about strategic analysis and the model of financial analysis to ensure the comprehensiveness of the content. This paper focuses on the differences between Coca-Cola and other enterprises from the perspectives of revenue and cost, which concludes that the reasons behind Coca-Cola's high profit rate is the company's excellent

development strategy and cost control.

The following section is as follows. The first section is industry analysis to realize the macroeconomic environment, and then the second section concentrates on the main strategy of the company, which shows the significant competitiveness compared with other companies. The third section uses a mass of data from company's annual report to analysis the reasons of high gross profit margin. Finally, the last section draws a conclusion based on the above analysis.

2. INDUSTRY ANALYSIS

With the development of science and technology and the enrichment of material production, more and more people choose to drink beverages, which leads to the significant growth and massive market of the beverage industry every year. Carbonated drinks accounted for more than a third of the market. However, with the change of people's consumption concept, more and more people pay more attention to healthy, low-sugar drinks, which makes the carbonated drinks occupy more minor and less market share. The market share of carbonated drinks decreased yearly from 36.9% in 2016 to 35.2% in 2020[2]. In 2019, when the global soft drink industry was not affected by the pandemic, the market size of the soft drink industry reached 869.7 billion US dollars, in which carbonated drinks ranked no. 1. And in the three years leading up to 2019, the number has been increasing. However, this data fell to \$7,700 billion in 2020 due to the impact of the COVID-19 pandemic. Among them, the Asian market will contribute the most in 2020. The consumption of The Asian market exceeds that of the North American market, and it is a new market with less mature development and more remarkable development space[3]. With the increasing awareness of protecting the environment and implementing sustainable economic development, sustainable development has become a trend in the beverage industry. Even though many people are opting for single-use plastic straws amid the COVID-19 pandemic, this goes against the concept of sustainable development and economy, which will inevitably become obsolete after a certain period.

3. STRATEGY ANALYSIS

3.1. Unique Recipe and High Quality

Coca-Cola is the world's largest beverage company which occupies 48% global market share. The reason why this company always occupies the leading position in the beverage market is that Coca-Cola has a unique beverage recipe.

As one of the most valuable brands in the world, the recipe of Coca-Cola can be regarded as the company's top secret. Coca-Cola was invented by John Pemberton, a pharmacist in Atlanta, Georgia. After inventing a cough

syrup in his backyard in 1886, he took it to the nearby Jacko's pharmacy to sell. In 1887, in a lucky accident, someone mixed syrup with carbonated water and Coca-Cola, as it is known today, was born. On May 8, 1886, Dr. John Pemberton sold the first glass of Coca-Cola at Jacobs' Pharmacy in downtown Atlanta. Serving nine drinks per day in its first year, Coca-Cola was new refreshment in its beginning. See the story here of how it all began.

Coke's main ingredients are publicly available, including sugar, carbonated water, caramel, phosphoric acid, caffeine, and "dead" coca leaves. The core technology is the mysterious ingredient that makes up less than 1% of Coke -- the "7X commodity".

Some rumors said that the recipe is controlled by senior managers who have signed the confidentiality agreement is not allowed to sell this recipe, and they even are not allowed to take the same plane, in case of accident recipe lost. There are also rumors that three large parts of the recipe are kept in the bank and others are kept elsewhere. In this way, Coca-Cola protected its recipe and improve the mystique of brand, which attracted plenty of customers. Meanwhile there have been rumors that the recipe of Coca-Cola has been leaked, which helps Coca-Cola's market popularity to earn enough attention[5]. It is difficult to expand the market if only popularizing this taste because everyone has different preferences, so this marketing strategy which aims to stimulate the curiosity of customers has brought huge sales for the company.

The company wisely chose to protect the recipe as a trade secret, which is one of the most successful brand protection cases in business history. In contrast to Pepsi, Pepsi changes its beverage taste whatever the market needs.

Coca-Cola also has a very complete quality management system in the world. In Coca-Cola (China), every batch of fruit juice and pulp bought from Brazil and the United States will undergo more than 400 strict tests, including pesticide residue, microbial detection, heavy metal detection, etc., to ensure food safety.

3.2. Marketing Mix Strategy

3.2.1. Price Strategy

Coca-Cola adopts a low-price strategy, relying on large-scale production to reduce costs. For example, the automated production line of Coca-Cola can complete tens of thousands of bottles in one minute. Therefore, the labor takes a small proportion in the corresponding cost structure, so the price can be maintained at a relatively stable level. Most notable is that Coca-Cola uses mantissa to set price. If you look at the retail price of Coca-Cola, it's hard to see a round number, whereas most of them are sold as decimal numbers like .8 or .9. This special pricing method will make consumers feel that they are buying a

discounted product, which will attract more consumers to buy their products.

3.2.2. The Mode of Local Marketing

Coca Cola's advertising is diverse and creative.

They registered Santa Claus as a trademark. Santa's story has a clear and compelling narrative arc; Plots that exploit the neural infrastructure of empathy. Over the decades, with the input of countless writers, artists and oral storytellers, these disparate works have come together in the stories we know. The Coca-Cola Company has taken full advantage of their brand purpose's similarity to Santa Claus and established a close connection between the holiday figure and their products.

Besides that, Coca Cola has sponsored the Olympics since 1928 and has not stopped for a century. The International Olympic Committee currently has 14 TOP sponsors, among which Coca-Cola is the longest-serving bandits "energy and joy" is in line with the spirit of sports. The Olympics offer a unique opportunity for companies to reach millions of fans, ultimately strengthening their brands and boosting sales with targeted product and service messages. In addition, companies that sponsor the Olympics are increasingly investing in the right message, particularly the brand behind the product, its values and culture, its mission and brand mission and, most importantly, its impact on the world.

Coca-Cola has been sold in the United States since 1886 and is now sold in more than 200 countries and territories. But they launched a lot of distinctive localized advertising from the local culture and customs rather than adopt a single marketing strategy.

In 2015, Coca-Cola launched a "remove tag" in the Middle East, which aims to appeal the people pay attention to racial discrimination. During the campaign, the company removed the logo of the brand "Coca-Cola" from its packaging and kept only the white ribbon logo. In addition, the slogan of "Labels are for cans not for People" was printed on the bottle body to appeal to people in the Middle East to eliminate misunderstanding and racial discrimination[6].

Coca-Cola became a trend in the carbonated drink market as its distinctive American characteristics, which was regarded as a symbol of American culture at that time. With the growing market of Coca-Cola, they took the localization marketing strategy. Take the Chinese market as an example, Coca-Cola launched packaging bottles designed in Chinese, and shot different advertisements according to Chinese traditional culture and updated products with different capacities during festivals. Coca Cola once designed unique image called "Fu Wa" with Chinese characteristics as the packaging image for the Chinese Spring Festival, which implies prosperity and harmony, driving the brand quickly spread in China.

Compared with Pepsi, Pepsi spends most of its advertising expenses on celebrity spokespersons, but the popularity and commercial value of stars are limited by age groups and regions, which is not helpful for shaping the brand image[7].

3.2.3. Distribution System

Coca-Cola makes their branded beverage products available to consumers in more than 200 countries and territories through network of independent bottling partners, distributors, wholesalers, and retailers as well as consolidated bottling and distribution operations.

Coca-Cola's sales model is different from that of other companies. It adopts the "1+X" sales model[8]. To be more specific, it is the layout of a concentrate plant with several bottling partners. Coca-Cola has set up bottling partners in Mexico, the United States, China, and other market centers. The bottling partners purchase the concentrate or syrup needed for beverage production from the company or its authorized suppliers, and prepare, package, and sell it.

In addition, Coca-Cola focus on the establishment and maintenance of the terminal market. The company adopts the "101" sales model, which defines some wholesalers as 101 customers, and these wholesalers are responsible for the distribution of regional Coca-Cola products. Meanwhile, the bottling factory sends salesmen to carry out business promotion in the region. They directly get orders from the terminal and give them to 101 customers, and then 101 customers deliver the products to each terminal customer according to the orders in the shortest time.

Through this sales model, Coca-Cola's shelf placement and product image are prominent in both large shopping malls and stores. And there will not result in problems due to the geographical location of terminal Settings.

3.3. Cost Leadership

Coca-Cola's cost control throughout the main processes such as production and sales. In production, Coca-Cola uses Siemens's automation technology to improve the efficiency and low-cost production, which provides the company with excellent performance and reliable power supply, but also saves the installation and commissioning time of new power supply, thus reducing the occupation of funds and human resources caused by the commissioning of power supply[9].

To save the transportation cost of cans, Coca Cola built the factory of the can suppliers near the production plant, which not only saved the capital investment in the construction of the concentrate plant and the occupation of the funds and equipment, but also shortened the time from the input of financial resources to the output.

3.4. Acquisition

In January 2020, Coca-Cola acquired Fairlife, which occupies a strong position in the fast-growing field of high-end dairy products. Through the acquisition, Coca-Cola will be able to diversify its product range and meet customers' demand for healthy drinks. The company will be able to offer more products with lower sugar content, stronger functions, and healthier products.

In January 2019, the company acquired Costa. Costa is a coffee sales enterprise with a complete coffee supply chain and a strong sales platform. Coca-Cola can not only make up its own hot drink product gap and expand its product category through acquisition, but also use Costa's stores to update its sales model.

In addition, the company acquired C.H.I. in 2019, which is a leading enterprise in the beverage industry in Africa. Due to the company's good performance in the Nigerian market, they continue to make long-term investments in South Africa to expand market scale and enrich product categories.

3.5. Supply Chain

Coca-Cola follows a unique supply chain management system: the company produces only concentrated syrup and sells it to bottlers with exclusive territories worldwide. Other bottling companies with exclusive regional contracts with Coca-Cola mix the concentrated product with filtered water and sweetener to make canned and bottled finished products. Bottlers then distribute and sell Coca-Cola's products to their respective markets.

3.5.1. Upstream Activities

Upstream activities are limited to concentrate production. In the main raw materials include sugar and packaging supplier selection, Coca-Cola plays a leading role, the Coca-Cola company technical department according to the raw materials supplier location, scale, equipment level, management level, the supply and demand of raw material, select a batch of approved suppliers, bottling plants can only purchase raw materials from the approved suppliers. The primary basis for Coca-Cola to choose these suppliers is the quality of raw materials. By controlling the quality of raw materials, the quality of Coca-Cola products is fundamentally guaranteed. On this basis, consider other factors by controlling these factors to reduce costs.

3.5.2. Downstream Activities

Franchised distribution system

Coca-Cola's downstream activities focus on franchised distribution systems. Coca-Cola develops products, creates associated marketing and advertising

programs, and produces concentrated syrup, sold to individual bottlers with exclusive territories around the world. Coke also owns minority stakes in some large franchises, but fully independent bottlers have almost half of the products sold worldwide.

Most of these bottlers have exclusive rights to sell in predetermined geographic areas. The bottlers have freedom from the primary business guidelines Coca-Cola has set in operating procedures, customer relationship management, and query management.

In conclusion, firstly, Coca-Cola derives a significant portion of its net operating revenues from sales of concentrates and syrups to independent bottling partners. By signing a concession contract with the bottler, the Company gives the bottler the right to manufacture and sell the product at a fixed price in regional operation. In other words, Coca-Cola has built a strong partnership by investing proprietary assets in bottlers. Secondly, to balance the relationship between bottlers and the Company, Coca-Cola adopts the way of repurchasing concession to affect business activities of bottlers to stabilize the cooperative association. Finally, Coca-Cola established the bottler holding Company to manage the bottler's business activities. Through the above three supply chain management strategies, Coca-Cola has based a perfect supply chain system[10].

With the continuous exchange of cultures and the development of cultural diversity in the world, other beverage companies can introduce more flavors of drinks to meet people's demand for drinks. Other companies should also invest more money and energy in advertising research and development to attract more consumers of different ages and expand their customer base. Other beverage companies can also form a large beverage interest community through mergers or acquisitions to gain a more significant say in the beverage market.

4. FINANCIAL ANALYSIS

4.1. Horizontal Analysis

Table 1. Coca-Cola's financial performance ratios compared with the industry

Ratios (%)	Coca-Cola	Industry Average
Gross profit margin	59.3	39.3
Net profit margin	23.5	6.0
Operating profit margin	29.8	14.2

Showing in table 1, Coca-Cola's gross profit margin is

59.3%, which is exceptionally high compared with other companies in the same industry, laying the solid foundation of its leading position in the beverage industry.

The reasons for Coca-Cola's extremely high gross profit margin are its high revenue and its excellent cost control strategy. From the revenue side, compared with other companies in the same industry, Coca-Cola occupies a dominant market share of nearly 50%, far exceeding Pepsi's 18.3%. Coca-Cola has strong bargaining power in the market when pricing and possesses a large and stable favorable consumer group, giving rise to its massive amount of revenue, regardless of the slight decrease because of the epidemic. From the cost side, Coca-Cola enjoys excellent benefits from the economics of scales due to its dominant market share. Additionally, Coca-Cola's strategy of the bottled authorization system is the reason for its high profitability in the industry since the profit of Coca-Cola syrup is exceptionally high compared to the bottled business. On the other hand, when the economy is in recession, Coca-Cola will provide syrup to bottlers, allowing suppliers to produce Coke on their own, thereby passing on the risk.

Due to the staggering gross profit margin, Coca-Cola's operating profit margin is over two times the industry average even though its operating expense ratio is around the industry average. Also, Coca-Cola's net profit margin of 23.5% is also much higher than the industry average of 6%.

4.2. Financial Ratio Analysis

4.2.1. Financial Performance

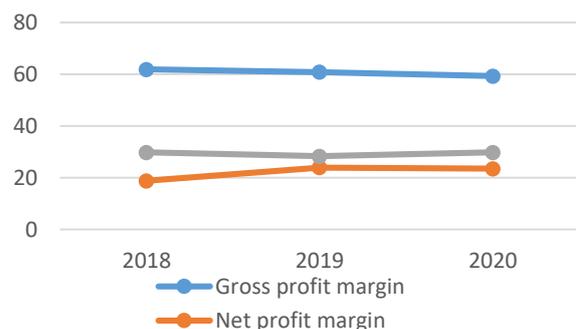


Chart 1. Coca-Cola's profitability ratio from 2018 to 2020

Gross profit margin is a profitability ratio showing the relationship between the gross profit and the total revenue, calculated by dividing the gross profit by sales revenue[11]. Chart 1 demonstrates that Coca-Cola's gross profit margin was maintained at around 60%, with a slight decrease from 61.9% in 2018 to 59.3% in 2020 due to the decline in revenue and an increase in the cost of sales.

The decline in sales revenue is undoubtedly affected

by the epidemic in the United States and worldwide. These reduced sales mainly come from restaurants, bars, stadiums, and movie theaters in public places that have been closed due to the epidemic. Although the company has increased the number of household purchases under the call of the home order, the added value of this part still cannot make up for the losses of other places. Also, the epidemic outbreak has caused delays in the production and export of Coca-Cola's raw materials, such as sucralose, a zero-calorie sweetener widely used in Coca-Cola's products. Problems on the supply side of raw materials have caused Coca-Cola's raw material costs to increase significantly. At the same time, the epidemic outbreak has also caused soaring labor costs and overheads, which jointly led to an increase in sales price. However, compared with other beverage industry companies, the slight fluctuation in Coca-Cola's gross profit margin is reasonable and very stable. Coca-Cola's sustained and high gross profit margin reflects its strong competitive advantage in this industry and its promising potential in profitability.

Operating profit margin is an indicator to measure the operating efficiency of an enterprise, reflecting its ability to obtain profits through operations without considering non-operating costs[11]. It is calculated by dividing the operating profit, the gain after the price, and other operating expenses by total revenue. Coca-Cola's operating profit margin has experienced a 1.5% decline from 2018 to 2019 since its operating expense increased gently from \$12081 in 2018 to \$12561 in 2019 in millions, and soon it had returned to 29.8% in 2020.

The increase in operating expenses may be related to Coca-Cola's all-category beverage strategy. Coca-Cola proposed to be a "full-category beverage company" in 2016, indicating that Coca-Cola will no longer stick to carbonated beverages but seek a strategic breakthrough in the entire category. To enter new markets, Coca-Cola has been acquiring continuously in recent years. Still, at the same time, it must pay a large amount of audit and evaluation fees, attorney fees, and consulting fees. At the same time, to promote new products, Coca-Cola invested a lot of advertising and marketing expenses.

While in the long term, the operating profit margin of Coca-Cola is showing a steady upward trend, which indicates that Coca-Cola has well managed its operating expenses in the past few years via a series of accurately positioned marketing strategies and complete company management strategies to control operating expenses.

4.2.2. Financial Condition

Table 2. Coca-Cola's financial condition ratios compared with the industry

Indicators	Coca-Cola	Industry Average
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Inventory turnover days	90.3	52.6
Receivable turnover days	39.3	39.1
Payable turnover days	99.5	76.0

Compared with the industry average showing in table 2, Coca-Cola's inventory turnover period is relatively long, reflecting its disadvantages in the sales of inventories. And the inventory turnover period is showing an upward trend, especially from 80.6 days in 2018 to 90.3 days in 2019.

The longer the inventory turnover days, the slower the company's inventory turnover, reflecting the poor sales performance of Coca-Cola in recent years. The low inventory turnover is that consumers around the world pay more attention to health, who are gradually losing interest in high-sugar carbonated beverages. However, Coca-Cola relies on carbonated drinks for more than 50% of its revenue, reflecting Coca-Cola's marketing expenses and related R&D expenses. Although the trade receivable days of Coca-Cola of around 39 days is comparable to the industry, its trade payable days of 99.5 days are much longer than. And in the long run, Coca-Cola's accounts payable turnover days are showing an upward trend, which means that the company can use more supplier payments to supplement working capital without short-term borrowing from banks. This may be since the Coca-Cola Company's continuous growth and dominant market share in the past ten years, leading to Coca-Cola's more robust and more muscular bargaining power with its suppliers. This advantage, on the other hand, also helped Coca-Cola reduce financial expenses.

5. CONCLUSION

Since its inception, Coca-Cola has blended with social development and inspired innovation. Coca-Cola, which has a global market share of nearly 50%, started out selling just one product. For a long time after that, Coca-Cola sold almost the same cola drink, with a few other products. But coke's net profit, which has nearly halved in recent years, and declining revenues each year have forced the company to move toward becoming a full-category beverage company in 2016. With the rapid development of beverage marketing, Coca-Cola continuously increases product sales to maintain its market share. It has implemented a wide variety of measures to ensure its high profit margin. In 2018, Coca-Cola continued to accelerate the pace of promoting the complete category strategy through the "upgrade - transformation - scale" model, constantly upgrading and expanding the product portfolio, launched around 500 products worldwide. Through their efforts, the company maintains operating expenses keep the approximate level

similar to the industry level in recent years. Still, the company's profit margin is much higher than the industry average. Through analysis, it can be seen that Coca-Cola's unique strategies in terms of revenue and cost have brought excellent benefits and high-profit margins compared with other competitors.

Speaking of the measures of increasing sales revenue, the mysterious recipe of Coca-Cola is the unique characteristic, and the company has used this feature to attract a lot of public attention and advertising. Then, they have made massive efforts in product design and advertising. They use the local features and cultures to design different packaging and local advertisements. Especially in some unique festivals, they produce an additional capacity of products and prints distinctive patterns or slogan on the packaging. Meanwhile, Coca-Cola adopts the "1+X" sales model and "101" sales mode, which hand over the rights of product production and sales to bottling partners worldwide and set up terminal product of purchase points all over the world, even in some remote areas. Finally, the company has acquired some beverage brands operating well in different marketing regions, such as Fairlife and Costa. These brands not only have brought a diversity of products to Coca-Cola but also updated its sales model.

In terms of the strategies about cost control, Coca-Cola has taken extraordinary control measures in both production and sales. In production, the company focuses on increasing the efficiency of production. They used Siemens's automation technology, which saves the installation and commissioning time of the new power supply. In sales, they established an excellent distribution system and supply chain. To be more specific, in upstream activities, the technical department of Coca-Cola selects plenty of approved suppliers based on many factors, including the location, scale, equipment level, and so on. The bottler can only purchase raw materials from these suppliers based on quality—the company controls these factors to reduce costs. And in downstream activities, the company gives the bottler the right to manufacture and sell the product by signing a concession contract. Meanwhile, they establish the bottler holding companies and use repurchasing concessions to manage the bottlers' operating activities.

In general, this article has drawn significant conclusions through the analysis of company strategy and financial data, which shows the reasons behind the high-profit margin of Coca-Cola are its excellent marketing strategies and cost control.

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