COCA COLA HBC

The effect on Coca Cola HBC’s corporate governance following Russia’s invasion of Ukraine

Exam: Corporate Governance (BINBO1427E)

Examination number:

Submission: 15.06.2022

Number of Pages: 5 + appendices

Program: BSc International Business

1. Introduction

After being founded in Greece by A.G. Leventis in 1969, Coca-Cola Hellenic Bottling Company, also known as Coca-Cola HBC, has grown to be the world's third-largest Coca-Cola anchor bottling firm in terms of volume (NNR, 2020). The business's primary function is to produce and sell the beverages owned by The Coca-Cola Company, which it distributes to 29 countries across three continents. The total sales across all these markets accumulated in total revenue of 7,168 million euros in 2021, resulting in an increase of 16,9% from 2020, which can be seen in appendix 6.2 (Coca Cola HBC, 2022). This strong market position, making them one of the most dominant firms in the beverage market, has been obtained through a horizontal integration strategy, where the latest acquisition was of the second-largest non-alcoholic ready-to-drink producer in Africa, Coca Cola Bottling Company of Egypt (Arthur, 2022). Furthermore, this strategy imposed to increase the product portfolio has the purpose of gaining a more prominent geographical presence, especially in emerging markets. (Coca Cola HBC, 2022). However, these markets are also under threat due to Russia's invasion of Ukraine earlier this year, which, after much public pressure, forced Coca-Cola HBC to suspend all operations in Russia related to the Coca-Cola (Reuters, 2022). This is one of the primary reasons for the significant drop in the company's stock price, which has decreased by 33,46% this year (London Stock Exchange, 2022)

In this report, I will by looking at the ownership, management, and board structures of Coca Cola HBC, identify the overarching corporate governance problems which the Russian invasion of Ukraine has caused and how recent and future changes in the firm’s governance will affect both the company and its shareholders.

2. Ownership structure and voting-power

As mentioned above, Coca-Cola HBC came into 2022 with an excellent financial foundation and a plan to continue organic growth by enrolling recently acquired brands into already present markets and further focusing on the development in emerging countries (Coca Cola HBC, 2021). However, things have been going to plan due to the recent conflict between Russia and Ukraine. As seen in appendix 6.3, emerging markets make up most of both sales in volume, where they experienced a growth of 18,6% from the year before and operating profit. Unfortunately, Russia makes out 27% of these sales, which after the suspension, therefore, will cause a decrease in operating profit of 81.1 million euros[1].This decrease accounts for more than the total operating profits in developing markets and must therefore be considered a massive loss for the business. At the same time, deciding to keep selling none-Coca-Cola related products in Russia is also controversial. It raises the question of whether this is the best decision for both shareholders and stakeholders, which is the first identified governance problem to be discovered.

[1] $Loss\ in\ operating\ profit = 409 * 0.20 = 81.1\ million\ euros$. It says in the annual report that the Coca-Cola brand accounts for 74% of the sales, which means -> 27*0,74 = 20% rounded.

2.1 Concentrated ownership of Coca Cola HBC and alignment in interests

The first main problem identified regarding the Russian invasion is the current ownership structure of Coca-Cola HBC. The firm has a concentrated ownership structure, where The Coca-Cola Company and the holding firm Kar-Tess both own around 23% of the shares, and the last 54% are minority shareholders (Orbis, 2022). It is essential to mention that Coca-Cola HBC only has ordinary shares, and The Coca-Cola Company and Kar-Tess are blockholders in the firm. A consequence of this structure is undermining the minority shareholders, as their best interest isn't always considered, especially the passive minorities who are only in it for the profits. The suspensions of all business activities Coca-Cola related activities in Russia have, therefore, caused a type II agency problem. In the company statement it says (Coca Cola HBC, 2022):

> *"Following the recent announcement by The Coca-Cola Company to suspend its business in Russia, we respect the decision and are working in close alignment on its implementation."*

This statement indicates that Coca-Cola HBC has primarily decided to leave Russia based on The Coca-Cola company's decision (Coca Cola HBC, 2022). The day before this statement, The Coca-Cola Company experienced a backlash in public reputation, as people were unhappy with the firm not having left Russia yet (Sharp, 2022). This is further strengthened by the fact that they haven't suspended its other brands. The most important part of The Coca-Cola Company is the brand, which is, therefore, the most necessary element to protect. This is also reflected in the decision to leave Russia and maintain its good reputation and CSR profile. The same goes for Coca-Cola HBC, which is listed as an AAA CSR company, which therefore leads to the question of why they haven't closed all operations yet?

Furthermore, Coca-Cola HBC heavily relies on The Coca-Cola Company to secure future growth, as it is their leading supplier and shareholder. On the other hand, Kar-Tess seems to have the same long-term interest, as it is owned by the Leventis family, who founded Coca-Cola HBC and are still a part of the board. Kar-Tess holdings only have shares in Coca-Cola HBC and is, therefore, also heavily reliant on future growth (EthicalConsumer, 2022). As theory says, family-owned businesses are more long-term orientated and care about the family reputation as well, which means that leaving Russia, was the optimal choice for Kar-Tess (Kachaner, Stalk, & Bloch, 2012). However, deciding not to leave Russia completely, as it could create a CSR type III agency problem between the owners and the public.

Among the majority shareholder, there seem to be interest alignment to save a good company reputation and secure long-term profits instead of following the ongoing short-termism trend (Knott, 2017). However, another problem seems to be that the reasoning behind these decisions is not communicated publicly to the minority shareholders. It can't be found in the statement by either Coca-Cola HBC or The Coca-Cola Company. This indicates that there is adverse selection in the form of hidden information about the actual purpose of the company leaving Russia. This causes a type II agency problem that must be addressed by management.

Moreover, the decrease in expected net profit will, besides the impact on the shareholders, from a drop in share prices, also include a significant reduction in the annual dividend being paid out.

Decreasing profitability will lead to a lower dividend if the group follows its published dividend policy to pay out 35-40% of the year's net profits. Further, the promised increase in pay-out ratio to 40-50% of the annual net profit risks being decreased due to the drop in profitability. The minority shareholders, who invested due to short-run profits, will suffer negatively from this, which causes further complications of the type II agency problem. This, all in all, indicates that the company is firmly orientated instead of owner orientated, as they care more about business relations and survival instead of higher profits for their minority shareholders. A concentrated ownership strategy makes attracting new owners difficult, making Coca-Cola and Kar-Tess even more critical (Choi, 2016).

2.2 Rising problems between shareholders and stakeholders

In continuation of the above, the decision also seems to impose a potential type III agency problem. As mentioned, the decision to leave Russia will have material adverse economic consequences for Coca-Cola HBC, with the loss of 20% of the company's total volume sales. Such an immediate loss of revenue and profit will naturally impact the ability of Coca-Cola HBC to meet its obligations to its creditors. From the annual report 2021, the company owes almost 3 billion euros to various credit institutions and bondholders (appendix 6.4). This debt has increased further in 2022 following the acquisition mentioned in the introduction. In addition, the group has total liabilities of 5,4 billion euros. Thus, other creditors such as suppliers, employees, and authorities (VAT, custom duties, and tax) amount to 2,4 billion euros. Although the current assets amount to 3,2 billion euros and thus should be sufficient to cover the short-term liabilities, it seems likely that the terms and conditions on the external debt would have been different and more burdensome had the lenders known that the net profit would be reduced. They would likely have charged higher interest rates due to the higher risk (Chen, 2021).

Finally, another type III agency problem might occur between the employees and the owners. Losing the majority of sales in Russia will, of course, result in Coca-Cola HBC laying off many workers, which is not in the best interest of the employees, as they want to keep their job (Madaschi, 2010). If they are not laid off, they might receive pay cuts or other negative consequences.

3. Board Structure

Currently, Coca-Cola HBC has a one-tier board composed of 13 members, whereas the CEO, Zoran Bogdanovic, is the only executive director on the board (Coca Cola HBC, 2022). Furthermore, the board consists of 9 men and four women who have different competencies from their working experience. This means that the board is somehow diverse, as seen in appendix 6.5. Increased diversity on the board can help improve the diversity of thought and helps handle complex corporate issues (DirectorPoint, 2022). It can be argued that women are underrepresented on the board. A higher representation of women on the board leads to a higher focus on CSR, management practices, and general environmental responsibility. None of these are value-creating in themselves, but by doing good, they strengthen the brand perception and, thereby, long-term growth, which is also aligned with the ownership structure (Martin, Petty, & Wallace, 2009). Despite the relatively good diversity on the board, specific issues are coming to the surface.

3.1 Independence in the board of directors

First of all, according to EU Corporate governance guidelines, the board should have a majority of members who are independent (IFC, 2015). However, according to Coca-Cola HBC's webpage, only six out of 13 board members are independent, meaning there is not a majority of independent representatives on the board. Independent board members tend to be more objective and reliable. In addition, independent members measure performance with numbers and thus bind the firm's responsiveness to the stock market. This increases firm value, improving monitoring level and interest alignment between stakeholders and shareholders (Gordon, 2006).Last but not least, despite there not being CEO duality in the firm, CEO Zoran Bogdanovic is still on the board of directors, which is not always beneficial, i.e., one of the board's tasks is to appoint the CEO (Warner, 2021). Furthermore, having the CEO on the board helps mitigate management challenges inside the firm, but it also increases the possible need for increased monitoring, which will increase agency costs.

3.2 No employee representatives in the board

Another problem regarding the board structure is the lack of codetermination, which means there is no employee representative on the board of directors. This means that workers' voice isn't represented in group negotiations or board meetings. As a potential result of this, workers can't be provided with the necessary information and additional competencies which can evolve into workers using more drastic and costly ways of being heard, such as strikes (Smith, Tennent, & Russell, 2019). This further builds on the type III agency problem, which was addressed following the potential conflict regarding employees in Russia and subsidiaries working with them. The Coca-Cola Company, which has a significant influence on Coca-Cola HBC, has recently experienced problems with their employees, as they have failed to pay the correct wage and give the legally required breaks to their employees (Shaak, 2021). These problems might also become relevant for Coca-Cola HBC, due to them having to lay off employees or potentially cut wages or working hours due to the decrease in sales.

4. Issue related to management behaviour

Over the previous year, and especially in the months right before the invasion, several insiders in Coca-Cola HBC started to sell their shares. This includes The General Counsel, Jan Gustavsson, who made the largest insider sale, worth 678 thousand British pounds, on the London Stock Exchange (Simply Wall St., 2022). In addition, CEO Zoran Bogdanovic also sold most of his shares at the end of last year, when the conflict between Russia and Ukraine began. Moreover, after the invasion, Zoran Bogdanovic sold more of his shares and then repurchased them at a lower price just weeks after (Markbeat.Com, 2022). This shows signs of entrenchment, as their experience with finance from their position might have benefitted them in predicting the massive drop in share price following the suspension of activities in Russia. This can be caused by the members of the board who are not focused on the interests of the shareholders. Instead, they are more concerned with their interests. This has also led many institutional minority investors to sell their stock (Financial Times, 2022). In conclusion, these actions might have given shareholders and stakeholders the impression that the firm's future is not in a good state.

5. Recommendations to management team and board of directors

As a conclusion to the above analysis of the current corporate governance problems Coca-Cola HBC is facing, I will give a few recommendations to solve some of the most prominent issues:

First short recommendation would be to leave Russia altogether before the potential public backlash. The firm builds on its brands and its reputation is critical for the business. The loss of the last 7% of revenue, found in the analysis, will be better to lose than to face a complete boycott in the rest of the markets. They must live up to being an AAA CSR company, which means they can be paying corporate tax and duties, which indirectly finances the war.

Next, the identified agency II problem under point 2.1 is not easily fixed as it is a commercial decision on how many shares the two large shareholders want to hold. However, in my view, it is recommendable that in a situation where two large shareholders hold de facto control, these large shareholders should have formal procedures in precautions being taken to ensure that the minority shareholders', both private persons, authorities and creditors, interests are kept at the forefront when making decisions. Such precautions don't seem to be in place, as the press release indicated that the decision was taken in respect of The Coca-Cola Company. If the board also assesses the decision to be in the best interest of the minority shareholders, a clear recommendation would be to improve the external communication strategy so the rationale behind it, seen from the benefit of the company, is clear to everybody.

Another recommendation that can be easily implemented is expanding the board or electing new members from the group of employees to mitigate the potential type III agency problem mentioned under point 2.2. This will also improve the diversity of the board and decrease codetermination, which will be important in the future due to the firing and potential restructuring of employee contracts. It will, however, not solve the issue with the many dependent board members, although employee representatives can be expected not to automatically vote alongside the board representatives appointed by the two large shareholders. If the ladder is to be solved, this will require an increasing proportion of independent board members i.e., election of new members will be needed, whereas it will be possible to get more female representation on the board as well.

Finally, although management's possibility to trade in the company's shares is already heavily regulated, the transactions by, especially the CEO, leave a wrong impression. It could, in my view, be considered to have internal guidelines that even further restrict management's possibility to actively sell or buy shares in the company in a situation where a significant transformation is on the way. This might require an increase in monitoring and agency costs, but it will send the proper signal to both shareholders and stakeholders.

6. Appendix

Appendix 6.1 - Table of Contents

Table of Contents

Appendix 6.2 - Total Revenue

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	2021	2020	% change
Volume (million unit cases)	**2,412.7**	2,135.6	13.0
Net sales revenue (€ million)	**7,168.4**	6,131.8	16.9
Net sales revenue per unit case (€)	**2.97**	2.87	3.5
Currency-neutral net sales revenue[2] (€ million)	**7,168.4**	5.994.9	19.6
Currency-neutral net sales revenue per unit case[2] (€)	**2.97**	2.81	5.8
Operating profit (EBIT)[3] (€ million)	**799.3**	660.7	21.0
Comparable EBIT[2] (€ million)	**831.0**	672.3	23.6
EBIT margin (%)	**11.2**	10.8	40bps
Comparable EBIT margin[2] (%)	**11.6**	11.0	60bps
Net profit (€ million)	**547.2**	414.9	31.9
Comparable net profit[2,4] (€ million)	**578.1**	431.4	34.0
Comparable basic earnings per share[2,4] (€)	**1.584**	1.185	33.7

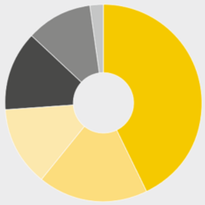
Percentage changes are calculated on precise numbers.

Appendix 6.3 - Emerging Markets and Russia

Established markets:

	2021	2020	% change
Volume (million unit cases)	**590**	537	9.9
Net sales revenue (€ million)	**2,479**	2,175	14.0
Operating profit (EBIT) (€ million)	**286**	203	40.5
Comparable EBIT (€ million)	**301**	209	43.9
Total taxes[1] (€ million)	**131**	111	17.4
Population[2] (million)	**94**	94	–
GDP per capita (US$)	**44,414**	39,552	12.4
Bottling plants (number)	**15**	15	–
Employees (number)	**6,251**	6,407	(2.4)
Water footprint (billion litres)	**3.751**	3.744	0.2
Carbon emissions (tonnes)	**65,577**	67,450	(2.8)
Safety rate (lost time accidents >1 day per 100 employees)	**0.44**	0.55	(20.0)

Volume breakdown by country (%)

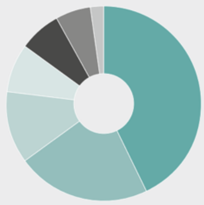


1. Total taxes include corporate income tax, withholding tax and deferred tax, as well as social security costs and other taxes that are reflected as operating expenses; as per IFRS accounts.
2. Population source: International Monetary Fund, World Economic Outlook Database, October 2021.

Developing markets:

	2021	2020	% change
Volume (million unit cases)	**416**	412	0.8
Net sales revenue (€ million)	**1,366**	1,171	16.6
Operating profit (EBIT) (€ million)	**105**	97	7.9
Comparable EBIT (€ million)	**107**	102	4.3
Total taxes[1] (€ million)	**46**	63	(27.6)
Population[2] (million)	**76**	76	–
GDP per capita (US$)	**19,622**	17,494	12.0
Bottling plants (number)	**9**	9	–
Employees (number)	**4,261**	4,581	(7.0)
Water footprint (billion litres)	**3.214**	3.159	1.7
Carbon emissions (tonnes)	**45,633**	44,927	1.6
Safety rate (lost time accidents >1 day per 100 employees)	**0.47**	0.33	42.4

Volume breakdown by country (%)

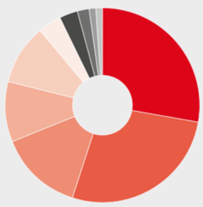


1. Total taxes include corporate income tax, withholding tax and deferred tax, as well as social security costs and other taxes that are reflected as operating expenses; as per IFRS accounts.
2. Population source: International Monetary Fund, World Economic Outlook Database, October 2021.

Emerging markets:

	2021	2020	% change
Volume (million unit cases)	**1,407**	1,187	18.6
Net sales revenue (€ million)	**3,324**	2,786	19.3
Operating profit (EBIT) (€ million)	**409**	360	13.5
Comparable EBIT (€ million)	**424**	361	17.3
Total taxes[1] (€ million)	**189**	169	12.2
Population[2] (million)	**453**	448	1.1
GDP per capita (US$)	**6,334**	5,705	11.0
Bottling plants (number)	**32**	32	–
Employees (number)	**16,700**	16,734	(0.2)
Water footprint (billion litres)	**10.721**	8.654	23.9
Carbon emissions (tonnes)	**314,582**	319,544	(1.6)
Safety rate (lost time accidents >1 day per 100 employees)	**0.14**	0.11	27.3

Volume breakdown by country (%)



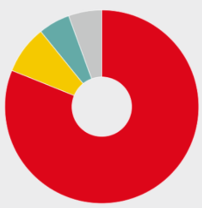
1. Total taxes include corporate income tax, withholding tax and deferred tax, as well as social security costs and other taxes that are reflected as operating expenses; as per IFRS accounts.
2. Population source: International Monetary Fund, World Economic Outlook Database, October 2021. Population includes N. Macedonia.

Figures are rounded. Percentage changes are calculated on precise numbers.

Appendix 6.4 - Borrowing Structure and Liabilities

2021 Borrowing structure (€ m)

€2,937m

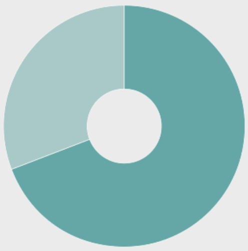


	2021 €million	2020 €million
Assets		
Total non-current assets	**5,357.4**	5,046.0
Total current assets	**3,156.9**	2,527.1
Total assets	**8,514.3**	7,573.1
Liabilities		
Total current liabilities	**2,516.4**	2,026.2
Total non-current liabilities	**2,880.8**	2,913.6
Total liabilities	**5,397.2**	4,939.8
Equity		
Owners of the parent	**3,114.5**	2,630.7
Non-controlling interests	**2.6**	2.6
Total equity	**3,117.1**	2,633.3
Total equity and liabilities	**8,514.3**	7,573.1

Figures are rounded.

Appendix 6.5 - Board diversity

Board gender diversity



Men	9
Women	4

Board tenure

0-1 years	2
1-2 years	1
3-4 years	1
4-5 years	1
5-6 years	3
6-7 years	2
7-8 years	2
14-15 years	1

Board age profile

40 to 49 years old	3
50 to 59 years old	5
60 to 69 years old	5
70 years old or more	0

Board nationality profile

American	1
American/Brazilian	1
Brazilian/Italian	1
British	4
Croatian	1
Greek	2
Nigerian	1
Swiss	2

Board experience

Finance, investments and accounting	12
International exposure	13
FMCG knowledge/ experience	6
Risk oversight and management	12
Sustainability and community engagement	8
Corporate governance	7

Appendix 6.6 - Sources

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