Coca-Cola Hellenic Bottling Company AG

Name of study: B.Sc. International Business

Course name: Corporate Governance

[redacted]

Characters (incl spacing): 10,880

Date: 15/6-2022

Executive Summary

The following report aims to outline and analyze the overarching challenges we are facing because of Russia's invasion of Ukraine, in a corporate governance perspective. The main focus of the report will be the decision of staying in Russia vs. fully suspending operations and the structure of our board and ownership.

Background

We have been a major strategic partner to The Coca-Cola Company (hereafter referred to as TCCC) since the middle of the 20th century when we started specializing in bottling and have since the 1990's expanded to 29 markets as of 2022 (*Integrated Annual Report 2021*, n.d.). TCCC is one of the two major shareholders in our company alongside Kar-Tess (holding company in Luxembourg). TCCC and Kar-Tess both own approximately 23% of our shares and have appointed 6 of our 12 board members. In May of 2022 we received a rating of "AAA" for the 8th time in a row from MSCI ESG. This, once again, puts us in the forefront of sustainability and shows our determination to focus on sustainability performance (*ESG Ranking*, n.d.).

We started our venture in Russia in the late 1990's and the country is now one of our biggest markets and made up 18% of our consolidated operating profit in 2021 (*Integrated Annual Report 2021*, n.d.). As Russia started the invasion of Ukraine on February the 24th, it shook the world and lead to companies needing to make significant decisions regarding their operations in Russia ("Ukraine War in Maps," 2022). When TCCC decided to suspend its business in Russia on March 8th its share price had already seen a drop of 7% as seen in appendix "1" (*The Coca-Cola Company Suspends Its Business in Russia | Press Release*, n.d.). Until the announcement they had seen public criticism alongside other big US companies such as; Starbucks, McDonalds, and PepsiCo for not suspending their business in Russia (Lucas, 2022). In Coca Cola Hellenic Bottling Company we saw an even more dramatic decrease in share price (London Stock Exchange) of 32% as seen in appendix "2" before our announcement to implement the changes proposed by TCCC (*Ukraine and Russia Update*, n.d.). Our announcement was, however, rather vague and we are still operating our local brands in Russia (*First Quarter 2022 Trading Update*, n.d.).

Decision of staying in Russia or fully suspending operations

According to Friedman (1970) a company's sole purpose is to maximize its profits which is aligned with the interests of our shareholders. Since the Russian market made up 18% of our profits in 2021, only partially suspending operations in Russia is the correct decision, in the short-term at least. As previously stated, we have a strong ESG profile that we risk damaging by staying in Russia since it is the general opinion from the public that companies should withdraw their operations (Islam, 2022). Doing business in a conflicted state such as Russia after the invasion of Ukraine can seriously harm a firm's reputation (*Companies Face Conflict between Ethics and Profit in War Zones*, 2017). Thus, we need to consider whether short-term profits are outweighing long-term value maximization since keeping our operations in Russia might lead to a dent in our company's reputation, thus hurting our long-term profitability.

According to stakeholder theory as proposed by Freeman (1984) a company should create value for all stakeholders, not just shareholders. This opens up for type III agency problems and conflicting interests between our shareholders and stakeholders. If we are to focus on our stakeholders, it also includes our Russian suppliers, customers, and employees who would all be affected by the decision to completely suspend operations in Russia. Although staying in Russia would satisfy our Russian stakeholders, we also need to consider our stakeholders outside of Russia. In order to satisfy our stakeholders outside of Russia whose interest in this case includes philanthropy in particular, we would need to fully suspend our Russian operations. Furthermore, keeping Russian operations going might lead to a misalignment between our interests and those of TCCC. Not only would this greatly damage our relationship but also lead to significant agency type II problems because of TCCC's status as a controlling owner and their interests of leaving the Russia in order to maintain their brand reputation.

I suggest that we consider fully suspending our operations in Russia in order to maximize our long-term profits while keeping up our great reputation. Furthermore, I also suggest that we develop emergency compensation packages for our Russian employees and suppliers in order to maintain talent and keep our promise of improving our communities, and also to maintain our strong relationships with suppliers.

Ownership and Board structure

According to page 93 of our annual report, neither Kar-Tess or TCCC has the ability to fully control decisions with the exception of super-majority votes and other rare occasions. I will, however, for the sake of this report treat Kar-Tess and TCCC as controlling shareholders since they have great influence on the board and have the power to overrule certain decisions made by minority shareholders at the annual general meeting (*Integrated Annual Report 2021*, n.d.). Another sign of significant control can be seen in that Kar-Tess and TCCC have successfully appointed six members of the board including the chairman of the board, Anastassis G. David. Therefore, we have a concentrated ownership structure with two large owners that can exercise significant control.

The separation between the controlling owners, Kar-Tess and TCCC, and the minority owners gives rise to agency type II problems but also lowers the risk of type I problems since they have greater incentives to monitor and control our management. A factor that we need to consider before it becomes relevant is the matter of private benefits of control, in case either Kar-Tess or TCCC show signs of other objectives than profit maximization.

TCCC might have conflicting interest in terms of favoring the TCCC share value over the CCHBC share value since they have significant experience working in TCCC and most likely have several personal relations with executives from TCCC. TCCC also has interest in spending money on investments that will result in innovations that other strategic partners across the world can also utilize. Kar-Tess is a holding company associated with the late Anastasios George Leventis who founded our company in Nigeria in 1951 (*Integrated Annual Report 2021*, n.d.). Even though we can expect Kar-Tess to be interested in profit maximization in order to maximize the value of their shares in the company, we need to be aware that they might develop conflicting interests in the case we need to make decisions between maximizing profits and the legacy of the company.

Our board consists of a one-tier board with a majority of non-executives. Our board consists of 13 highly professional directors with strong finance and industry-specific experience. According to Jensen (1993) and Lipton & Lorsch (1992), the optimal board size should be 7-8 people since larger boards become less effective because the problems caused by coordination and process outweigh the benefits gained from having more people to give input. Beiner et al. (2004), however, concludes from an analysis of Swiss based companies, that there is no correlation between board size and financial performance. It is, however, still relevant for us to consider the possible efficiency losses we suffer from having a rather large board. A smaller board of e.g., 8 directors would allow more streamlined decision making with less coordination between the board members. This would, however, also mean a loss of not only input, but also the networking effects that our current board of 13 brings to the table. Six out of our 12 board members are independent non-executives, not including the chairman (*The Board*, n.d.). It is debated whether a majority of independent directors is preferable in order to represent the shareholders in the best way possible. Since independent board members are more likely to exercise control and monitor the management as well as decisions regarding the business, they are necessary in a professional board. Independent directors are, however, overrated because of the information asymmetry that exists between the independent directors and the management of the firm according to Gilson & Kraakman (1991) who also conclude that independent directors lead to higher remuneration for executive management. Bebchuk & Hamdani (2017) conclude that even independent directors are still susceptible to influence from the management team, controlling investors, and other board members. Thus, a large proportion of independent directors might not be superior to a 50/50 split as required by the UK Corporate Governance Code (Copnell, 2018).

An issue that might become problematic is that three members of the board are directly related to the late Leventis as can be seen in appendix 3. These members of the board have significant interest in the profit maximization of our company since they are beneficiaries of a private discretionary trust with direct ties to Kar-Tess but might also have family interests in CCHBC that overshadow profitability such as survival of our company and A.G. Leventis' legacy.

Until now, the concentrated ownership and largely dependent board of directors hasn't constituted a problem for our company since we have been very transparent with decision-making and paid out dividends to satisfy shareholders. I, however, suggest that we prepare procedures for a scenario in which one of our controlling owners develop conflicting interests.

Concluding thoughts and suggested actions

In general, our company is running well and didn't exhibit urgent challenges up until Russia's invasion of Ukraine. Since the invasion of Ukraine we have been facing a new set of challenges and need to address these challenges before they get out of hand.

The first problem we are facing is whether we should fully suspend our business in Russia or keep local products in operation. To this problem I highly suggest that we fully leave Russia considering the interests of both our shareholders and our stakeholders outside of Russia. I also recommend that we look at the option of creating an emergency compensation package to our employees and suppliers in Russia in order to maintain talent and relationships.

The second challenge we are facing is less urgent and action should be taken as a precautionary measure rather than a fix to a current problem regarding procedures in case our controlling owners develop misaligned interests. I suggest that we consider a scenario in which our controlling owners develop conflicting interests with our minority owners and develop a procedure, should it happen.

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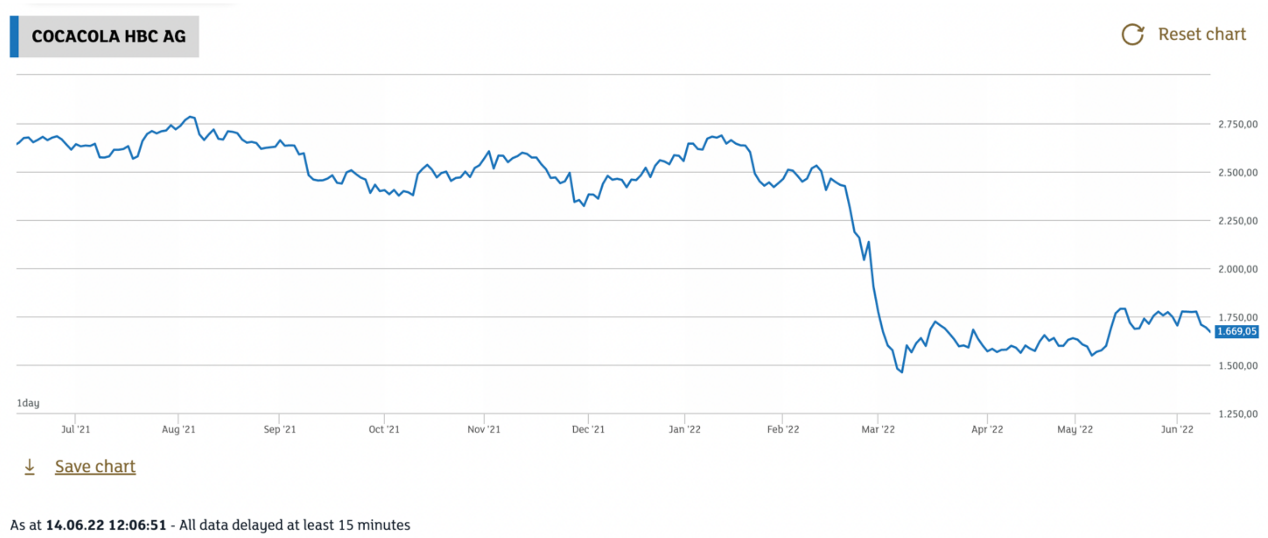
Appendices

Appendix 1.

Source: (*The Coca-Cola Company (KO) Stock Price, News, Quote & History - Yahoo Finance*, n.d.)

Appendix 2.



Source: (*CCHBC Stock*, n.d.)

Appendix 3.

Share ownership

The table below summarises the total shareholding as at 31 December 2021, including any outstanding shares awarded through our incentive plans, for the Chief Executive Officer and other Directors. There have been no changes in the interests of any Directors in shares in the period to 16 March 2022.

		With performance measures			Without performance measures						
		PSP			ESOP			ESPP			
Name	Share interests	Performance shares granted in 2021	Unvested and subject to performance conditions	Vested	Number of stock options outstanding	Fully vested	Vesting at the end of 2021	Number of outstanding shares held as at 31 December 2021	Beneficially owned	Current shareholding as % of base salary[1]	Shareholding guideline met[1]
Zoran Bogdanovic[2]	Yes	97,206	327,430	48,829	162,477	162,477	–	47,641	193,729	722%	Yes
Anastassis G. David[3]		–	–	–	–	–	–	–	–	–	–
Charlotte J. Boyle	Yes	–	–	–	–	–	–	–	1,017	–	–
Henrique Braun		–	–	–	–	–	–	–	–	–	–
Olusola (Sola) David-Borha		–	–	–	–	–	–	–	–	–	–
Anna Diamantopoulou		–	–	–	–	–	–	–	–	–	–
William W. (Bill) Douglas III	Yes	–	–	–	–	–	–	–	10,000	–	–
Reto Francioni	Yes	–	–	–	–	–	–	–	7,000	–	–
Anastasios I. Leventis[4]		–	–	–	–	–	–	–	–	–	–
Christo Leventis[5]		–	–	–	–	–	–	–	–	–	–
Alexandra Papalexopoulou		–	–	–	–	–	–	–	–	–	–
Bruno Pietracci		–	–	–	–	–	–	–	–	–	–
José Octavio Reyes		–	–	–	–	–	–	–	–	–	–
Alfredo Rivera		–	–	–	–	–	–	–	–	–	–
Ryan Rudolph		–	–	–	–	–	–	–	–	–	–

1. The shareholding requirement was introduced from the date of the 2015 PSP award, 10 December 2015 and has been updated to 300% in 2020.
2. Zoran Bogdanovic holds 19,113 stock options with an exercise price of £15.50 dating from the Stock Option 2010 Grant. This grant was originally due to expire on 9 December 2020. However, due to a restriction on trading in company shares, these options were not able to be exercised. The Remuneration Committee therefore agreed a temporary extension in the expiration date of these options of 30 days after the end of the restricted period, in line with the provisions of the relevant plan rules. He exercised 43,538 options which were due to expire 2021.
3. Anastassis G. David is a beneficiary of:
(a) a private discretionary trust, for the primary benefit of present and future members of the family of the late Anastasios George Leventis, that has an indirect interest with respect to 85,355,019 shares held by Kar-Tess Holding and
(b) a further private discretionary trust, for the primary benefit of present and future members of the family of the late Anastasios George Leventis, that has an indirect interest with respect to 832,268 shares held by Ari Holdings Limited.
4. Anastasios I. Leventis is a beneficiary of:
(a) a private discretionary trust, for the primary benefit of present and future members of the family of the late Anastasios George Leventis, that has an indirect interest with respect to 85,355,019 shares held by Kar-Tess Holding and
(b) a further private discretionary trust, for the primary benefit of present and future members of the family of the late Anastasios George Leventis, that has an indirect interest with respect to 286,880 shares held by its trustee, Selene Treuhand AG and
(c) a further private discretionary trust, for the primary benefit of present and future members of the family of the late Avgie Leventis, that has an indirect interest with respect to 2,138,277 shares held by Carlcan Holding Limited.
5. Christo Leventis is a beneficiary of:
(a) a private discretionary trust, for the primary benefit of present and future members of the family of the late Anastasios George Leventis, that has an indirect interest with respect to 85,355,019 shares held by Kar-Tess Holding and
(b) a further private discretionary trust, for the primary benefit of present and future members of the family of the late Anastasios George Leventis, that has an indirect interest with respect to 482,228 shares held by its trustee, Selene Treuhand AG and
(c) a further private discretionary trust, for the primary benefit of present and future members of the family of the late Avgie Leventis, that has an indirect interest with respect to 2,138,277 shares held by Carlcan Holding Limited.

Source: (*Integrated Annual Report 2021*, n.d.)