

Into the Fryer
How Coke Officials Beefed Up Results Of Marketing Test
Consultant Gave Kids' Clubs Cash to Buy Value Meals In Burger King Promotion
Wiring \$9,000 for Whoppers

By CHAD TERHUNE

RICHMOND, Va. For several days three years ago, Dyquan Gibson and his friends had a strong incentive to study every afternoon at the neighborhood Boys & Girls Club. "If you finished your homework, you got a burger," says Dyquan, who is now 11 years old.

Dyquan and his friends didn't know it, but the free Whoppers came from a consultant hired by Coca Cola Co. Officials at the Atlanta beverage company had sent the man to Richmond with \$9,000. He gave cash to the clubs and other nonprofit groups and told them to treat the children to hundreds of "value meals" at Burger King.

Millions of dollars in sales were at stake for Coke. The company was trying to persuade Burger King to run a national promotion for its slushy dessert drink, Frozen Coke, which Burger King sells at all of its restaurants. But Burger King wanted to run a test promotion before it invested in a big campaign. So the Miami-based restaurant chain ran a two-week test in Richmond, offering a coupon for a free Frozen Coke when customers bought a value meal – a sandwich, fries and drink combo. If the meals sold well enough, and enough people redeemed the coupons, Burger King would take the promotion national.

The Coke officials embarked on the buying spree because the initial test results were dismal. In the end, their efforts added only 700 value meals to the nearly 100,000 sold during the promotion. But even that small number helped bolster Coke's case for a national push. Burger King sank roughly \$10 million into the campaign.

Even in the freewheeling world of fastfood sales and marketing, Coke's gambit stands out. Although the ploy was allegedly hatched by two mid level executives, apparently without the knowledge of Coke's top brass, the deception of Burger King has badly embarrassed the beverage giant. It has also put it under the scrutiny of federal prosecutors, who are probing the Frozen Coke debacle.

Earlier this month, Burger King confirmed that a federal grand jury in Atlanta sent it a subpoena seeking information related to the Frozen Coke promotion. Prosecutors are expected to interview shortly the Coke officials involved in the test to determine what charges, if any, to pursue. In addition, the U.S. attorney's office in Atlanta and the Securities and Exchange Commission are examining unrelated allegations of accounting fraud at Coke raised by a former internal auditor, who blew the whistle inside the company on the faulty Frozen Coke test. The auditor is now suing Coke for wrongful termination.

Coke denies the fraud allegations and says it is cooperating with investigators. It acknowledged in June that some of its employees "improperly influenced" the sales results in Richmond, and that the actions were "wrong and inconsistent with the values of the Coca Cola Co. " It issued a public apology to Burger King and agreed to pay the company and its franchisees up to \$21 million to make amends. A spokesman for Burger King, which is owned by a private investment group comprised of Texas Pacific Group, Bain Capital and Goldman Sachs Capital Partners, says, "We are

very pleased to have reached a resolution" with Coke.

The airing of this dirty laundry has been one of the few blemishes for Coke lately. The company is showing signs of breaking out of a five-year slump. And some on Wall Street have become optimistic about the company again, as it cut costs and Steven Heyer, Coke's president, assembled a new management team. Net income, which fell to \$2.18 billion in 2000 from \$4.13 billion in 1997, was \$3.05 billion last year.

Internal Coke memos reviewed by The Wall Street Journal, and accounts from people in Richmond and at both companies, shed light on the Coke officials' motivation in boosting the test results. At the time of the Richmond test, Coke was facing a flat soft drink market and fending off aggressive moves by arch rival PepsiCo Inc., particularly in the fountain drink business. A year before the test, in fact, Pepsi waged a bidding war to try to grab Burger King's business. Coke controls about two thirds of the U.S. fountain drink market, and 44.3% of the soda market overall. PepsiCo has 22% and 31.4%, respectively.

With 8,000 restaurants in the U.S., Burger King is Coke's second biggest fountain customer after McDonald's Corp. Coke's annual revenue from Burger King is estimated to be more than \$200 million. Overall, Coke's fountain unit, now called food service, accounted for about a third of the company's \$6.3 billion in North American sales last year.

Over the years, Coke has advised Burger King on everything from improving drive through business to breakfast items. The theory: More business for Burger King means more potential Coke buyers. In the mid 1990s, Coke pitched Frozen Coke to Burger King as a way to boost its dessert and snack sales.

Frozen Coke dates back to the early 1970s, when it was introduced in convenience stores and other retail outlets to compete against brands such as Slurpee. About a dozen Burger King restaurants introduced Frozen Coke in 1997. Two years later, Burger King mandated that all of its franchisees install a Frozen Coke dispenser.

In 2000, Coke wanted to boost its revenue from Burger King, whose overall sales were down. The beverage company thought that Frozen Coke could bring new customers into the restaurants specifically, women and children in the afternoons.

But Burger King executives wanted to test a Frozen Coke promotion in one city before committing to the national advertising campaign Coke was pushing for. The restaurant chain's new french fry had just flopped, and its independent minded franchisees had rejected Burger King's idea of a free Whopper promotion as too costly for them. So Burger King set up the test in Richmond. The companies would compare the results there of value meal sales and Frozen Coke coupon redemptions with results in Tampa, Fla., which wasn't running the promotion.

If the Richmond promotion failed, Coke risked losing Burger King's confidence and the national promotion Coke needed to hit its projected numbers for fountain sales. It was the first big test for John Fisher, who had just taken the helm of Coke's Burger King account team. The vice president was known as a talented salesman and dynamic speaker, and was considered a rising star at Coke. One of his marketing managers, Robert Bader, oversaw the Frozen Coke test. Mr. Fisher, 40 years old, and Mr. Bader, 45, decline to comment for this article.

The Richmond test was set to begin on Feb. 28, 2000. The results of the first week were thrown out because of a problem with the TV advertising. The test was restarted the next week, and the sales numbers didn't improve. Burger King executives criticized the Coke team for not doing enough to support the test, according to a memo Mr. Bader later wrote to Coke auditors. "I was personally excoriated by [Burger King's] project leader on a heated, unpleasant phone conversation," Mr. Bader wrote in March 2001. "It was clear that unless test results improved, the national Frozen Coke promotion was not going to happen." Burger King declines to comment on details surrounding the test.

The Coke team blitzed Richmond Burger Kings. They called store managers to ensure Frozen Coke coupons were being distributed. They handed out T shirts and other prizes to cashiers who sold a lot of value meals. One of their ways of finding good cashiers was to "mystery shop." It's a routine practice: Companies have their employees or outside firms make purchases at their own stores to test customer service or collect other insight.

But time was running out on the test. On the evening of March 8, according to his memos to auditors, Mr. Bader withdrew \$360 from his personal bank account at an automated teller machine in the lobby of Coke headquarters. A co-worker also made a withdrawal. They gave the money to two Coke employees who were flying to Richmond that week to join other team members already there. "We asked them to begin buying larger quantities of value meals," Mr. Bader said in his memo.

It isn't clear from Mr. Bader's memos whether he was asking the employees to try to inflate results, but by the following evening he had halted the value meal purchases. "I was very uncomfortable with the need for our over the top intervention," he wrote.

The next day, Mr. Fisher, Mr. Bader's boss, instructed him to "re establish the mystery shop program." In a March 2001 memo explaining the test to his own boss, Tom Moore, president of Coke's fountain unit, Mr. Fisher wrote that Coke and Burger King "both needed the May [national] promotion to go forward." Mr. Moore declined to comment.

Mr. Bader and another member of the Coke team decided to hire an outsider to orchestrate an even bigger round of burger buying, according to one of Mr. Bader's memos. They hired Ronald Berryman, an Atlanta marketing consultant who had worked for Coke on other Burger King promotions.

Mr. Bader wired \$9,000 from his personal Visa card to Mr. Berryman on Monday, March 13, spending another \$400 for the transaction fee. Mr. Berryman arrived in Richmond that same day. He had lunch with Esther Hyatt, who at the time was development director for the Boys & Girls Clubs of Metro Richmond.

Mr. Berryman told Ms. Hyatt he was doing product testing for Burger King and needed the help of several nonprofit organizations, according to Ms. Hyatt. Mr. Berryman explained that he would give the clubs cash for the meals, and the children would have a choice of value meals.

Ms. Hyatt says she was wary of accepting the offer. She says she didn't like the nutritional message that comes with a diet of burgers, fries and soft drinks. But other club officials were more enthusiastic about the donation as a reward for the club's members, predominantly poor, black kids.

The next morning, Mr. Berryman attended a Boys & Girls club staff meeting. He gave a short presentation and handed out cash to the directors of several clubs. David L. Ross, a club director, got enough money to buy about 100 value meals for Dyquan Gibson and a dozen other kids at the Afton Avenue club. Overall, more than 300 children at the area Boys & Girls clubs ate 1,200 or more value meals that week, club administrators' estimate.

Mr. Ross says he wouldn't have accepted the money if he had known about Coke's involvement. "It was deceitful," he says. "We try to teach these kids honesty."

According to its financial records, Coke paid Mr. Berryman \$5,000 for his work in Richmond and for other projects. Mr. Berryman, through his lawyer, declined to comment.

As it turned out, some of the effort was wasted. The Boys & Girls clubs, and other Richmond groups approached by Mr. Berryman, bought many of their value meals after Burger King stopped tracking Richmond sales on March 16.

Mr. Fisher flew to Burger King headquarters in Miami shortly after the test ended, claiming strong results. Coke's buying spree contributed just 700 additional value meals to the 95,200 purchased during the two-week test, according to internal Coke memos. But as Mr. Fisher's PowerPoint presentation showed, the Richmond restaurants reported a 6% increase in value meal sales versus 2% for Tampa. The 700 meals represented about 13% of the increase in Richmond.

Further, Mr. Fisher noted, the Richmond outlets served 61 Frozen Cokes a day during the test, including outright purchases and coupon redemptions. This was an improvement over the average March sales of 39 Frozen Cokes per day at Burger King outlets overall.

In memos to franchisees, Burger King executives stressed that the test results showed a national Frozen Coke promotion would drive increases in sales and profits. In the summer of 2000, Burger King launched a national "Fire & Ice" promotion: If customers bought a Spicy Chicken sandwich, they'd get a Frozen Coke coupon.

The story might have ended there had it not been for a routine audit. On Aug. 9, 2000, Mr. Bader filed an expense report for \$4,432.01 for the "Richmond mystery shop" with dozens of Burger King receipts attached. Mr. Fisher approved it. That amount represented the receipts returned by Mr. Berryman, the consultant.

About five months later, Matthew Whitley, the internal audit manager in Coke's fountain division, randomly pulled Mr. Bader's expense report during the routine audit. Mr. Whitley says he thought the amount of meals purchased for a "mystery shop" was excessive.

On March 2, 2001, Mr. Whitley and another auditor quizzed Mr. Bader about the expense report. In follow up memos, Mr. Bader defended Coke's "unconventional" methods in using Mr. Berryman as being "entrepreneurial." He told the auditors he disagreed with Mr. Fisher's decision to restart the value meal purchases, but he considered it a judgment call by his boss. "I would never have agreed to move forward if I believed I was being asked to commit an ethics code or legal transgression," Mr. Bader wrote.

Mr. Moore, the head of Coke's fountain unit, wanted an explanation from Mr. Fisher. In a memo to

Mr. Moore, Mr. Fisher argued that the value meal purchases were necessary to compensate for an unfair comparison between Richmond and Tampa. He said the Florida city was warmer in March, which would increase drink sales there. "We had to deseasonalize the data in order to have an accurate measure," he wrote. "I am not completely aware of the details of how the shops were executed but take full responsibility for the decision to execute the program."

Mr. Whitley says he and the other auditor recommended that the company fire Mr. Fisher. Senior executives at Coke opted for a lighter punishment. The company cut Mr. Fisher's 2000 bonus in half and eliminated his stock option award for 2001. "These actions exposed the Coca Cola Co. to a risk of damage to its reputation as well as to the relationship with a major customer," Mr. Moore wrote in a May 17, 2001, disciplinary report.

Two months later, Coke's audit committee was informed of the Frozen Coke affair when it received an internal quarterly report on employee code of conduct violations. The audit committee then consisted of chairman Peter Ueberroth, now candidate for governor of California; billionaire investor Warren Buffett; Cathleen Black, president of Hearst Magazines, a unit of Hearst Corp.; and Ronald Allen, retired chairman of Delta Air Lines. They all declined to comment beyond what the company has already said on the matter.

At the time, Coke didn't tell Burger King what it had learned concerning the Richmond test. Coke declines to comment on why not.

About two years later, on Feb. 4, 2003, Mr. Whitley sent Mr. Heyer, who had just recently become Coke's president, an e mail about the Richmond test and unrelated allegations of accounting fraud and earnings manipulation. Mr. Heyer didn't respond to the e mail, Mr. Whitley says. Mr. Heyer declines to comment. On March 26, Deval Patrick, the company's general counsel, responded to a follow up e mail from Mr. E Whitley and pledged to conduct an internal investigation into his allegations. Mr. Whitley lost his job that same day.

In May, Mr. Whitley, 37, filed wrongful termination suits against Coke in state and federal court in Atlanta. Whitley contends he was retaliated against for being a whistleblower

In court documents, Coke said Mr. Whitley's termination was part of 1,000 layoffs in the company's North American operations. Coke has asked the courts to dismiss Mr. Whitley's lawsuits.

Mr. Fisher was promoted to a top marketing job in the fountain division earlier this year. In April, internal auditors at Coke questioned him about swapping theme park tickets purchase company for Notre Dame football tickets according to people familiar with the matter. He left the company soon after, but Coke declines to why Mr. Bader works as a marketing manager for the fountain division, but is not in the Burger King account.

Frozen Coke still hasn't lived up to its expectations. The Fire and Ice promotion was a disappointment. Average sales per restaurant last year sank to nearly 22 a day – less than half of Coke's original estimate of 48. Burger King is hoping a name change to Icee will turn it around.

Source: The Wall Street Journal, Wednesday, August 20, 2003.

