DUAL DISTRIBUTION AND DOUBLE MARGINALIZATION
IN FRANCHISE SYSTEMS: THE CASE OF COCA COLA USA

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In the late 1970s, the two major carbonated beverage concentrate manufacturers in the U.S. (Coca Cola and Pepsi) started increasing downstream vertical integration (Muris et al 1992, 1993). This shift towards captive distribution, with the trade name franchisor taking over (directly or through a subsidiary) franchisee bottlers continued apace in the 1980s. The prevailing rationale for these actions by the franchisors (presented by Muris et al 1992, 1993) is grounded in the idea of organizational efficiency. They posit that changes in the operating environment in the carbonated beverages industry made it more efficient for the franchisors to take over bottling and retail distribution functions from the franchisees. However, empirical evidence about the poor financial performance of the captive bottling organizations as well as the tapered nature of vertical integration (as opposed to complete vertical integration) raises concerns about the organizational efficiency rationale for the shift from fully franchised operations to dual distribution (defined as the joint use of franchised and vertically integrated channels of distribution). In this paper, we posit and demonstrate an alternate rationale for the shift to dual distribution that is consistent with empirical results of Muris et al (1992) as well as with institutional evidence that cannot be accounted for by the organizational efficiency explanation. The foundation for our approach is the notion that Coke (and Pepsi) undertook this shift to dual distribution to overcome the double marginalization problem (Lerner 1934, Spengler 1950), where a downstream franchisee (e.g., franchisee bottler with territorial exclusivity) charges a higher price and sells a lower volume in equilibrium than that sought by a profit-maximizing upstream franchisor (e.g., franchisor). We develop an analytical, game-theoretic model to evaluate and identify conditions where dual distribution is more profitable for a franchisor than using a completely franchised system or a fully vertically integrated system. Our results suggest that dual distribution is an optimal channel structure for moderate levels of intra-brand competition.

Keywords: Product Franchising, Trade Name Franchising, Dual Distribution, Channel Structure, Intra-brand Competition, Double Marginalization, Carbonated Beverages Industry, Coca Cola, Analytical Modeling, Game Theory, Case Study.