Coca-Cola (KO) and PepsiCo (PEP)

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Financial Decision Making

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**Introduction**

Both companies operate in the beverage industry. For decades, they have been the closest rivals. Coca-Cola, which offers more than 500 brands, operates in nearly two hundred countries around the globe. Coke's product collection includes some of the most valued drinks and brands in the world. This firm is regularly transforming its product portfolio, from decreasing the levels of sugars in its drinks to creating innovative new items to the market. It has also strived to reduce its ecological impact by replacing and encouraging recycling. On its part, PepsiCo is recognized for its excellent brands. It is the second leading beverage firm after Coca-Cola. For more than 50 years, this company has severed various markets across the world. While these two organizations continue to engage in fierce wars, this paper compares their performance and assesses, in which one provides the highest returns to its stockholders.

**Firms' Liquidity Relative to Industry Averages**

Liquidity for firms often denotes to the business' capacity to utilize their current assets to meet its obligations. The current ratio is one of the liquidity analyses that measure a business's ability to meet its current and short-term obligations (Agusta, & Hati, 2018). The other measure is the quick ratio, which measures a business's ability to use its near cash, also known as quick assets, to quench its liabilities (Agusta, & Hati, 2018). The following table compares the quick and current ratios of Coca-Cola and PepsiCo.

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| --- | --- | --- | --- |
| **Financial Ratios**  | **Coca-Cola** | **PepsiCo** | **Industry**  |
| Current Ratio | 1.09 | 0.97 | 1.15 |
| Quick Ratio | 0.63 | 0.7 | 0.82 |

As shown above, Coca Cola's current and quick ratios were 1.09 and 0.63, respectively (Coca-Cola, 2020). PepsiCo's current and quick ratios stood at 0.97 and 0.7, respectively, over the same period (PepsiCo, 2020). Both the companies' ratios were below the industry average, indicating that both firms have a higher risk of default. Often, a low current ratio value, usually less than one, shows that a business might have difficulties meeting its short-term and current obligations. When assessing the two firms, PepsiCo's current ratio (0.97) is lower than Coca Cola's current ratio (1.09), which means that PepsiCo is struggling to meet its liabilities. On the other hand, Coca Cola's current ratio is more than one, which implies that the firm is performing well and able to meet its liabilities.

With the quick ratio, both firms' ratios fall below the industry average. According to Agusta and Hati (2018), a lower quick ratio than the industry average means that the business is facing difficulty paying off its debts. While the industry ratio stands at 0.82, Coca Cola's quick ratio is 0.63, and PepsiCo's quick ratio is 0.7. When looking at these two ratios, PepsiCo's business appears to be doing well than Coca Cola. In particular, it means that Coca Cola is doing worse and has a lower ability to cover pay off its debts compared to PepsiCo.

**Firms' Solvency Relative to Industry Averages**

As for Agusta and Hati (2018), solvency refers to a business' state of financial health. In particular, it denotes a firm's ability to meet its long-term obligations. They argue that a Solvent business is one that has less than it owes others. In other words, such a business has a positive net worth and controllable debt commitment. One of the most used solvency ratios is the debt-to-equity ratio (Agusta & Hati, 2018). This ratio measures the extent to which a company utilizes financial advantage. A higher ratio denotes increased interest expenses, which might affect a business' credit rating. Besides, an increasing debt-to-equity ratio can also make it difficult for a business to secure or receive more funds. The next table compares Coca Cola and PepsiCo's debt-to-equity ratios.

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| --- | --- | --- | --- |
| **Financial Ratios**  | **Coca-Cola** | **PepsiCo** | **Industry**  |
| Debt-to-equity | 2.16 | 3.07 | 0.84 |

Generally, a higher value of debt-to-equity ratio than the industry average is hugely worrying. It also means that a higher ratio indicates a high risk. It equally suggests that a firm will face difficulties financing its growth through debt. When comparing the two firms, Coca Cola's ratio is given as 2.16, while PepsiCo's ratio is 3.07. Even though both ratios are higher than the industry average, PepsiCo's debt-to-equity ratio is higher than that of Coca Cola. It, thus, means that PepsiCo is carrying a higher-level debt when compared to Coca Cola. However, Agusta and Hati (2018) argue that debt-to-equity values that are more than one imply more risks in funding the company's business. Hence, because both company's values exceed one, it implies that they are experiencing problems financing their business operations.

**Firms' Profitability Relative to Industry Averages**

Agusta and Hati (2018) assert that profitability ratios play vital roles in measuring a firm's capacity to generate income. These ratios often show how efficient a business is at making profits. They also show if a business can create value for its shareholders. In particular, higher profitability ratios are preferred than lower ones. One of the most utilized profitability ratios is the profit margin, which compares profits to sales. It equally informs how well an organization is doing in handling its financial resources. From the following table, it is clear that Coca Cola is performing well than PepsiCo based on the given Profit margin.

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| --- | --- | --- | --- |
| **Financial Ratios**  | **Coca-Cola** | **PepsiCo** | **Industry**  |
| Gross Margin | 60.77 | 55.36 | 49.35 |
| Pre-Tax Margin | 28.94 | 13.87 | 15.25 |
| Net Profit Margin | 24.11 | 10.94 | 10.92 |
| Five-year average Gross Margin | 61.14 | 54.82 | 49.85 |
| Five-year average Pre-Tax Margin  | 22.50 | 13.73 | 15.31 |

References

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