PHILIP MORRIS: THE HOT HANDS IN CIGARETTES

From an also-ran in the industry to the nation's No. 2 producer

P.A. Gomez Jr.

When John T. Landry unveiled his marketing strategy for low-tar Merit cigarettes before the products committee of Philip Morris Inc. 14 months ago, there was more than the usual tension around the conference table. Landry, executive vice-president of marketing, told the committee that he intended to roll Merit into national distribution without doing any traditional test marketing. And to make the brand a success, he would spend at least $40 million on advertising and promotion in the first year. PM's so-called full-flavor Marlboro brand jumped into No. 1 place in the U. S. cigarette market during the year, but PM and other cigarette producers could see where that market is heading—toward low-tar brands. And until it put its hefty marketing push behind Merit, PM had no strong contender in that very important field.

The products committee, made up of eight senior Philip Morris executives, including Chairman Joseph F. Cullman III, has the power to veto any marketing plan or new product. But it gave Landry's radical plan the go-ahead, even though some members wondered aloud whether PM had bitten off more than it could chew.

Philip Morris has made a lot of right decisions in the past 15 years, and Merit unquestionably is one of the best. After less than a year on the market, it is the hottest new brand to be introduced since Winston ushered in the filter era in 1955.

The low-tar switch

This year PM will sell some 7.4 billion Merit cigarettes—$100 million worth. The low-tar brand has pushed into the ranks of the top 20 sellers—a feat that often takes years to accomplish. Most important of all, Merit will begin making money next year. Generally a new cigarette does not begin to pay off

Landry: He was able to guarantee Merit's success because of a $200 million plant.

Bus WK 12/6/1976

until its third year on the market, if ever.

Philip Morris is again blazing financial records. In the first nine months of the year, earnings were up 24% to reach $198.6 million and revenues rose 17.4% to hit $3.1 billion. PM looks for even bigger increases next year as its Miller Brewing Co. subsidiary begins making significant profit contributions (BW—Nov. 8) to the company.

Year by year the industry is becoming increasingly dominated by Philip Morris and its archrival, R. J. Reynolds Tobacco Co., of Winston-Salem, N.C. Though total industry shipments have not shrunk, despite 20 years of warnings on the hazards of cigarette smoking, growth has been feeble, averaging only about 1% annually in the past five years. So Reynolds and PM are taking larger and larger shares of a market that remains much the same size, and other producers are steadily losing ground.

The industry's output is changing, too, as PM's massive effort to move its low-tar Merit into the market shows. Future growth will come chiefly in the low-tar field, most producers believe, and they are all scrambling to get their low-tar entries on the market. But again, the Reynolds and PM brands dominate.

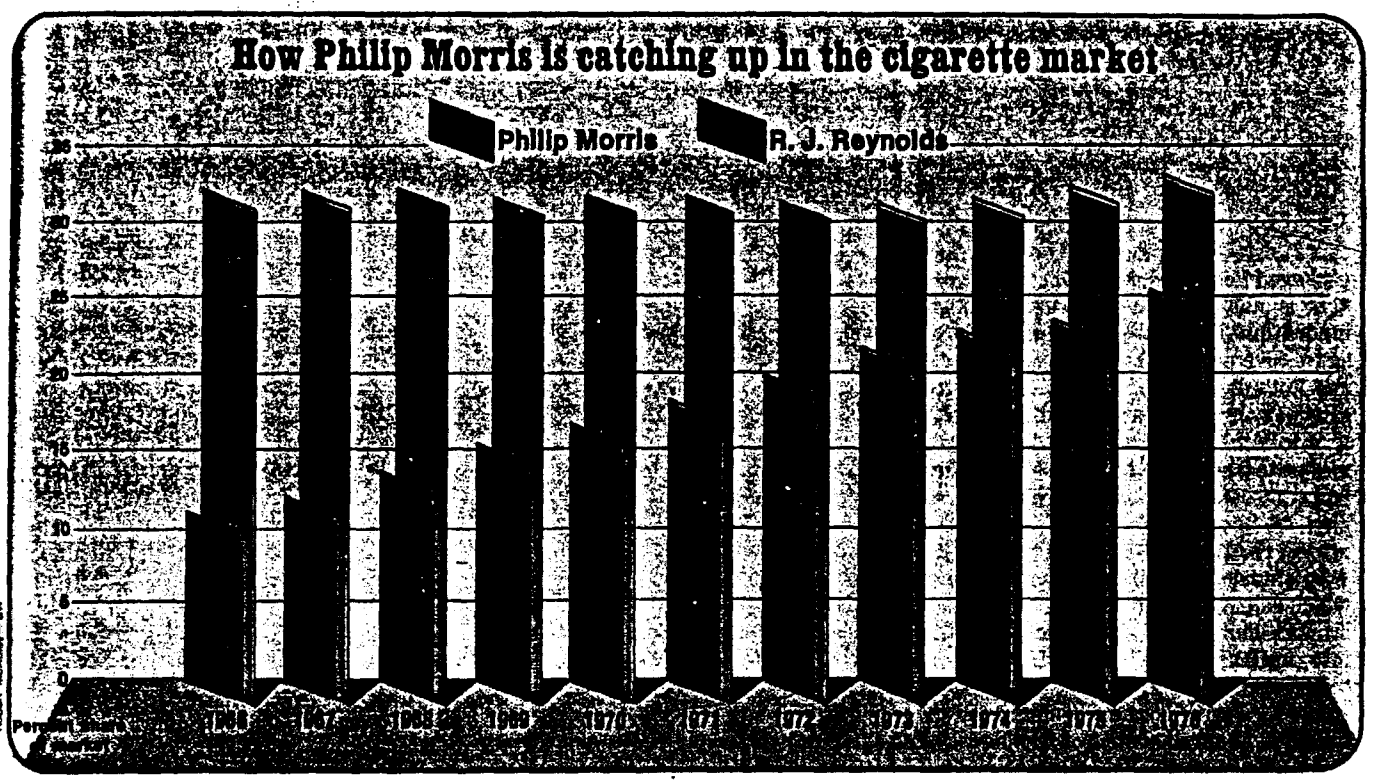
Publicly the industry has fought anti-smoking forces at almost every turn for the past 15 years, but it quietly has moved to comply with some of their suggestions. The push to low-tars, long urged by health experts, is a clear example of this. As Gio B. Gori, virologist at the National Cancer Institute, puts it: "Since the public persists in smoking cigarettes and other tobacco products, the only course of action that remains is to develop less hazardous cigarettes." In 1955, says Gori, commercial cigarettes averaged 43 mg of tar and 2.8 mg of nicotine. Today, he adds, those levels have dropped to 18 mg of tar and 1.2 mg of nicotine.

The swing toward low tar has also produced a change in the cigarette makers' advertising. Merit, Vantage, and other low-tar brands are no longer pushed with ads that try to emphasize free-swinging or fun images. Instead, their advertising rests heavily on text. In its ads for Vantage, Reynolds even faces up to the health question beneath a headline reading "Think." PM is trying a different tack by emphasizing the taste of its low-tar Merit. In each case, the companies perceive the market for their low-tar brands as being among those who already smoke.

But for the so-called full-flavor brands—Marlboro, Winston, and others—producers still stick to the images of glamour or hero-worship in their advertising, aiming the message at those aged 18 or thereabouts. That the message still works is plain from some of Philip Morris' own research. A sampling that it conducted last year showed that its biggest single group of customers—34.7% of them—were among those aged from 18 to 24.

But as the trend toward low-tar cigarettes accelerates, the full-flavor brands that now lead the market will start to drop in the rankings. That goes a long way to explain why Philip Morris plunged so heavily to get its low-tar Merit into distribution. The company's critics—most of them at Reynolds—have long said that PM was a one-brand company and that if its Marlboro brand ever began losing market share, the company would fall along with it. Merit positions Philip Morris' product line for the future, and the new brand's success also clearly demonstrates how PM makes its management revolve around marketing.

"We're a marketing organization," says Cullman. "Our success is related to our ability to market and merchandise,



using consistent and integrated themes aimed at the growth segments of the markets." Recognized as one of the nation's shrewdest marketers of consumer package goods, Cullman has taken the company from an also-ran in the tobacco industry to the second largest producer in the U. S., behind only Reynolds.

In 1961 Philip Morris was barely scratching out a living. That year the company had only 9.4% of the U. S. cigarette market, and it was the smallest of the six major companies. Today, PM has 25.2% of that market of 597 billion cigarettes. Worldwide, PM ranks second, behind only giant British-American Tobacco Co.

A shrewd marketer

Along the way Philip Morris has developed its own particular ways of operating in its segment of the consumer packaged goods market:

- It is not an innovator, even though innovation is usually the hallmark of aggressive packaged goods producers. PM has not pioneered in a single cigarette category. It waits patiently for competitors to establish a category, and then it moves to capitalize on others' mistakes and successes. By hewing to this philosophy, PM now has five brands (page 62) among the top 20.
- It shuns traditional test marketing, which calls for new brands to be sold in a limited number of cities before going into national distribution. In place of test markets, PM uses "taste test" panels—offering its new brands to large numbers of small groups of smokers and testing their reactions. By these means, PM believes, it can shield the results of its tests from competitors.
- It concentrates on the mass market, almost always avoiding specialty brands such as Liggett Group Inc.'s Eagle, a cut-rate product, and Brown & Williamson Tobacco Corp's Hallmark, a premium brand, that appeal to only a small percentage of the market.
- It encourages its manufacturing and research and development groups to offer ideas for new brands and new production techniques to the marketing specialists who head the company. The Merit brand, for example, originated with the R&D group, and marketing determined that there was room for another low-tar brand.

Maintaining communications among marketing, manufacturing, and R&D is a constant exercise at PM. Landry and his New York-based marketing staff fly to Richmond, Va., each month to meet with the production and R&D staffs. R&D keeps its own liaison man in New York. "He sits right here with us," says James J. Morgan, vice-president and assistant brand director.

By closely coordinating these three functions, Philip Morris is now in a position to overtake Reynolds, which has occupied the catbird seat since 1958, when it displaced American Tobacco Co.

If Reynolds and Philip Morris maint their growth patterns of the past fo years, PM would overtake Reynolds 1983. In that year, Philip Morris wo have a 37% share of the market vs. R 36.5% of total industry volume of billion cigarettes.

Landry is confident that PM will re

CIGARETTES IN 1976

THE TOP 20 BRANDS

Rank	Brand	Company	Sales: Billions of cigarettes 1976	1975	Percent change
1	Marlboro	Philip Morris	93.6	90.5	[illegible]
2	Winston	R. J. Reynolds	91.0	91.6	[illegible]
3	Kool	Brown & Williamson	60.0	61.9	[illegible]
4	Salem	R. J. Reynolds	52.4	50.2	[illegible]
5	Pall Mall	American	43.8	45.9	[illegible]
6	Kent	Lorillard	26.9	26.4	[illegible]
7	Benson & Hedges	Philip Morris	26.6	25.3	[illegible]
8	Camel	R. J. Reynolds	26.1	26.8	[illegible]
9	Tareyton	American	15.5	16.7	[illegible]
10	Vantage	R. J. Reynolds	14.4	11.3	[illegible]
11	Viceroy	Brown & Williamson	13.3	16.0	[illegible]
12	Raleigh	Brown & Williamson	11.8	14.1	[illegible]
13	L&M	Liggett & Myers	9.8	11.2	[illegible]
14	Lucky Strike	American	9.2	10.0	[illegible]
15	Virginia Slims	Philip Morris	9.0	8.1	[illegible]
16	Belair	Brown & Williamson	8.9	9.3	[illegible]
17	Parliament	Philip Morris	8.7	9.6	[illegible]
18	True	Lorillard	8.4	9.8	[illegible]
19	Merit	Philip Morris	7.4	—	NM
20	Carlton	American	6.6	5.0	+32.0

NM—not meaningful

HOW THE PRODUCERS RANK

Company	1976 Market share Percent	1976 Sales Billions of cigarettes	1975 Market share Percent	1975 Sales Billions of cigarettes	Percent change in sales vs. 1975
R. J. Reynolds	33.2%	198.0	32.5%	192.2	[illegible]
Philip Morris	25.2	150.4	23.8	140.8	[illegible]
Brown & Williamson	16.5	98.5	17.0	100.5	[illegible]
American	13.4	80.0	14.2	84.0	[illegible]
Lorillard	7.8	46.8	7.9	46.7	[illegible]
Liggett & Myers	3.9	23.1	4.4	26.0	[illegible]
All other	0.03	0.2	0.2	1.2	[illegible]
Total	100.0	597.0	100.0	591.4	[illegible]

that target sooner. "I think 1983 is the outside year that we'll pass Reynolds," he asserts. For its part, Reynolds hotly disputes the notion that it might lose its No. 1 position. William D. Hobbs, chairman of Reynolds Tobacco, snaps: "We have no intention of relinquishing our position of leadership in 1983 or in any other year in the foreseeable future."

But the battle is clearly on, and as the giants tussle, the other cigarette producers are losing ground. Only RJR and PM managed to post gains in unit sales this year, 2.9% and 5.8% respectively. Total industry output crept up by only 6 billion units. Meanwhile, Philip Morris' production alone jumped 9.6 billion units.

Until recently Reynolds and Philip Morris followed two distinctly different management philosophies. Reynolds, with its sales force of nearly 2,000, relied on hard-nosed salesmanship to move its brands. For many years the company gave little thought to a fully rounded marketing program, leaving this function to its advertising agency at the time, William Esty Co. For 30 years the agency, which created the slogan "I'd walk a mile for a Camel," called RJR's marketing shots while the company concentrated on manufacturing and pushing its brands into retail outlets.

Reynolds' method worked flawlessly throughout the 1960s when television was available to the tobacco industry. But when Congress barred the industry from advertising on TV and radio, problems began to creep into the RJR system. For example, the famous Winston jingle ". . . tastes good like a cigarette should" could not be transferred effectively to print advertising, and Winston's leadership position started to slip. As a result, Reynolds found that it had to employ a more sophisticated form of marketing.

Hobbs concedes that the company had let its agencies dominate its marketing program. "But we do it quite differently today," he says. "They get their directions from the brand management group." Reynolds had to begin building its marketing department almost from scratch, recruiting marketers where in the past salesmen handled what brand management there was. "Brand management really began to function in the early 1970s," says Hobbs.

Cullman: "We would just as soon sell Merit as sell Marlboro."

Peter Silver

Morgan: "We want to make sure Reynolds doesn't get a strategic advantage."

Joan Sydlow—BW

Goldsmith: "If we hadn't built the plant, we couldn't have gotten Merit out."

Joan Sydlow—BW

While RJR was struggling to get its marketing into line, Philip Morris began closing the gap in sales and manufacturing, the areas where Reynolds dominated. With the completion in 1973 of a highly automated, $200 million plant in Richmond, PM was able to claim with accuracy that it had the most modern and efficient cigarette production facility in the world. When Landry outlined his scheme to introduce Merit on a national scale, he was able to guarantee it because of the huge capacity of the new Richmond plant.

"If we hadn't built that plant, we couldn't have gotten Merit out," says Clifford H. Goldsmith, president of Philip Morris USA, and the man who pushed the building of the plant when he was in charge of production. "In 1972, before the Richmond plant opened, we didn't have capacity for one more cigarette, much less almost 8 billion more."

Despite Merit's high-volume production requirement, no snags developed in the company's manufacturing plants. So, while 7.4 billion Merits will roll off the computer-controlled production lines this year, PM will also produce 93.6 billion Marlboros, 26.6 billion Benson & Hedges, 9 billion Virginia Slims, 8.7 billion Parliaments, and several billion other cigarettes with less popular names.

But if careful planning averted the chance of bottlenecks in producing Merit, Philip Morris did face one major problem in getting its new cigarette on the market. Landry had intended to roll Merit into national distribution with his own sales force, which, numbering about 1,000, is only half the size of Reynolds'. But then he got word that Reynolds was preparing to push its low-tar brand, called Now, into the market in a hurry.

Landry had to rush, because retailers' point-of-purchase space is limited, and a high percentage of initial sales goes to the company that gets its brand to the retailers first. "We had to supplement the work force—and fast. We had advertising scheduled, and the manufacturing was on line. But if we couldn't get the cigarette distributed, all of this would be wasted," recalls Landry.

So Landry turned to Manpower Inc., the temporary personnel agency headquartered in Milwaukee. To beat Reynolds' Now to the retailers, Philip Morris contracted with Manpower to

provide about 200 experienced salesmen in the 10 major markets of the U. S. "At first we thought we would need them for only a month or six weeks, but because of the success, we had to keep Manpower on for four months," says Landry.

Manpower personnel called on retailers, set up Merit point-of-purchase materials, and passed out more than 1.2 billion of the new cigarettes in the 10 key markets. Selective sampling is common to the industry, but few companies have ever attempted such a massive sampling program.

Landry thinks that the move to Manpower helped Merit maintain its momentum, but he is intent on not being caught short in the sales area again. Philip Morris' goal is to have a sales force that will equal or exceed Reynolds' next year. "We're building," Landry says. "Not many years ago Reynolds' sales force was four times the size of ours. Today it is twice as big, but by the end of the year we will be three-fourths their size."

Saratoga vs. More

Since Philip Morris began its rise to prominence in the early 1960s, it had studiously avoided being a pioneer in introducing new categories of cigarettes. Such introductions are high-cost ventures and fraught with risk. So despite its aggressiveness in the marketplace, PM has left pioneering to Reynolds. "Our marketing objective," says Morgan, "is to make sure that Reynolds does not get a strategic advantage. We definitely aren't going to allow them to get a long-term advantage on us."

In 1974 this approach led PM to hit the market with Saratoga, a 120-mm cigarette designed to compete with Reynolds' More. Philip Morris moved its Saratoga national without benefit of test marketing. Saratoga, as a result, was on the market the same day that More made its national debut. More is still the No. 1 brand in that category, but PM has locked into second place, and its sales volume is not far behind the leader.

Some charge that Philip Morris habitually follows Reynolds' lead, and there is a lot of truth to the charge. Philip Morris kept close tabs on More's sales in test markets. The cigarette industry shares common distributors throughout the country, and it is no trick to find out how competitive brands are moving. PM also maintained a close watch on Reynolds' advertising program for More and observed the point-of-purchase material used in the retail stores. In addition, while More was in test, Philip Morris was running "taste panel" tests on its 120-mm brand.

Thus when Reynolds announced that it was moving into national distribution, Philip Morris had a good reading on how the public would react to the new cigarette. And by jumping quickly, Philip Morris assured itself of strength in the new category. But the other tobacco companies lagged by several weeks, and by the time their brands arrived, More and Saratoga had locked up the market.

The move to low-tars is another case in which Philip Morris is accused of letting Reynolds pave the way. "It was a void that they had to get into," says Charles P. Tucker, vice-president of marketing at Reynolds. "I will say that Philip Morris did a very good job. They spent a lot of money, but Vantage created the category for them to enter."

Chuck Rogers

Reynolds' Hobbs: "We have no intention of relinquishing our leadership position."

Landry and his marketing associates do not deny that Vantage did a lot to acquaint the public with low-tar cigarettes. But Philip Morris, Landry says, saw the need for a low-tar cigarette 12 years ago. It took that long to get the right formulation for Merit. "You can't force-feed a product to the market. There may be a need for low tars, but the cigarette has to taste good, too. There's no trick in making a cigarette with zero tar, but the consumer won't like its taste unless you've got the right formulation," says Landry.

While Philip Morris is toasting itself over the success of Merit, it is becoming increasingly concerned about the future of Marlboro. Though the brand is certainly No. 1, there are signs that it is beginning to age, and its growth is [illegible]ing. Two years ago it gained 17% [illegible] sales, but this year that pace [illegible] sharply to 3.4%.

A cigarette's life cycle is long, [illegible] still remain on the market, such [illegible] Camel, the first nationally distrib[illegible] brand and still the eighth most po[illegible] But few can hold onto the top rank[illegible] for many years. PM's Cullman recog[illegible] that when he says: "We plan to [illegible] with the marketplace. We'd just as [illegible] sell Merit as Marlboro."

Industry analysts look for Merit [illegible] Vantage to reach the top positions [illegible] day. Vantage, now ranked 12th, [illegible] creased its sales by 27.4% this year. As [illegible] neither the Vantage nor the Merit brand has yet, in industry parlance, "bee[illegible] extended or modified—that is, produ[illegible] in different forms, such as 100 mm [illegible] "light," or presented in different pack[illegible] ages. By contrast, Marlboro comes [illegible] eight different forms, about the limit [illegible] extension and modification. Soon [illegible] though, both Merit and Vantage wi[illegible] come in 100-mm form and packaged [illegible] hard boxes. "Coming out in 100-mm [illegible] form alone would easily add 2 billion [illegible] units to sales of each of the brands," says one industry analyst.

Both PM and Reynolds agree that low-tar cigarettes are the wave of the future.

The giants are growing

Today low tars (those containing less than 15 mg of tar) have 13% to 15% of the market. PM's Morgan believes that within 10 years the low-tar share will be up to 35%. All the tobacco companies are scrambling to come out with low-tar cigarettes, and many are reformulating old brands to bring down their tar and nicotine content.

Despite the steady shift to low tars, the prospect is that the two giants of the industry will become even more dominant in the U. S. market. In what many see as a sure sign of weakness, the other producers have flooded the market with new brand extensions. Since 1971, a total of 105 new varieties of cigarettes went on the market—but most disappeared from retailers' shelves after a short time, including such lackluster performers as Tramp, Mermaid, Twist, Zack, and Dawn. American Tobacco alone offered 26 new brands during that period. By contrast, Reynolds and PM each hit the market with only 15 brand introductions.

"When you're going well, you don't feel a desperate need to bring out new brands that might just sell. We have been able to be very deliberate," says PM's Landry. "We want our brands to appeal to the masses of consumers."