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DIVERSIFICATION IN THE CIGARETTE INDUSTRY IN THE 1980'S

An independent research project submitted
in partial fulfillment of the
requirements for the MBA degree

by
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Executive MBA, Class of 1988
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CHAPTER I

INTRODUCTION

This study is a comparative analysis of the diversification strategies of the six domestic cigarette manufacturers in the 1980's. It uses financial analysis to look at how the different cigarette manufacturers have invested the cash generated by the tobacco businesses, and how the companies rank in terms of their ability to generate profits and stockholder wealth in non-tobacco businesses.

The cigarette industry is a giant in the consumer goods area. In 1986, the cigarette companies achieved operating profits of approximately five billion dollars, on sales of 20 billion dollars. Such profits are unparalleled by most other industries. However, the industry has been steeped in controversy almost since its beginning in colonial America. That controversy heated up in the 1950's, with the first of a series of reports associating cigarette smoking with various health hazards. Since the 1950's, the cigarette manufacturers have pursued diversification strategies, in response to the threats to their original business, and also as a way to continue the growth that they had experienced in the earlier part of the 20th century, as the cigarette market developed and grew.

Diversification in the industry has been researched and documented in the past, in works such as Coffin Nails and Corporate Strategies by Miles (49), The Domestic Diversifying Acquisition Decision by Dory (26), and The Tobacco Industry in Transition, edited by Finger (28). These studies document the diversification of the "Big Six" cigarette manufacturers from 1954 through 1979. (For a description of the Big Six, see Table I). However, some of the most significant milestones in this on-going story have been reached in the 1980's. Philip Morris, the most successful of the Big Six cigarette manufacturers, became the last one to become "fully diversified", when it acquired General Foods in 1985. In 1986, for the first time, Philip Morris' tobacco revenues were less than fifty percent of total corporate revenues. In 1985 we also saw the merger of R. J. Reynolds and Nabisco to form RJR-Nabisco, another major milestone in the diversification story.

Diversification will undoubtedly continue in the future. However, the present time frame provides an excellent opportunity to stop and ask the questions "How have Big Six done with their diversification strategies?...Have the Big Six been able to apply the knowledge they gained in the 60's and 70's to their diversification moves in the 80's?". The questions can be approached in several different ways, using both qualitative and quantitative criteria. In both cases, the analysis is complicated by the large differences in the

successes of the Big Six within the cigarette industry. During the last two decades, the Big Six have separated considerably in terms of market share. Philip Morris and Reynolds have essentially become the "Big Two", with a combined market share of 69.2 percent (28, 47). This is contrasted with American and Liggett, with market shares of 7 and 4 percent, respectively. This large difference means that Philip Morris and Reynolds have had much more cash available to invest in non-tobacco interests than the others. It also means that Philip Morris and Reynolds did not have as much pressure to diversify out of cigarettes, and were able to take their time in selecting and implementing diversification options.

On the surface, it would appear that Philip Morris and Reynolds are the most successful at diversification. They rank 12th and 14th, respectively, on the 1986 Fortune 500, and they fit most descriptions of "blue chip" companies. However, it has been argued by some that Philip Morris and Reynolds have not been as successful as others, such as American Brands, in utilizing tobacco profits for diversification (67). The operating margin of American's non-tobacco businesses is higher than Philip Morris' and Reynolds'.

The relative success of the companies' strategies is analyzed in this study by looking at the non-tobacco versus tobacco

financial data for each company, and by contrasting the non-tobacco financial data among the companies. Interpretation of this data yields the answers to the question: how successful has each company been outside the cigarette industry?

In order to put the analysis in perspective, it is necessary to review the cigarette industry's development. It is especially important to look at the diversification decisions and results of the 50's, 60's and 70's, because they affected the decisions and results of the eighties. The next chapter gives a brief historical perspective of the development of the Big Six, and their diversification strategies. The reader who is familiar with the development and diversification history of the cigarette companies may wish to skip this chapter.

TABLE I

THE BIG SIX CIGARETTE MANUFACTURERS

COMPANY	PERCENT SHARE OF U.S. MARKET[1] (As of 12/86)	CORPORATE ENTITY
Philip Morris	36.8	Philip Morris Companies
R. J. Reynolds	32.4	RJR-Nabisco
Brown and Williamson	11.5	BATUS (BAT Industries)[2]
Lorillard	8.1	Loews Corporation
American Tobacco	7.2	American Brands
Liggett & Myers	4.0	Liggett Group

[1] Source: Maxwell, J. C. (47)

[2] Brown and Williamson Tobacco is a division of BATUS, which is a diversified, wholly owned subsidiary of BAT Industries, Great Britain.

CHAPTER II

HISTORICAL PERSPECTIVE

Early History of the Big Six Manufacturers

The modern cigarette industry began in the last half of the nineteenth century, when the cigarette began to gain popularity as a tobacco smoking product, replacing snuff and pipe tobacco. The American Tobacco company was organized by James "Buck" Duke of Durham County, North Carolina, in the 1890's. Duke absorbed sixteen small cigarette manufacturers, which included three of the manufacturers that make up today's "Big Six" (Reynolds, Lorillard, Liggett & Myers). Duke's American Tobacco Company held a virtual monopoly in the U.S. market. In 1902, American Tobacco merged with the Imperial Tobacco Company of Britain, to form the British-American Tobacco Company. The new company, led by Duke, controlled almost all the cigarette and tobacco product manufacturing and distribution in the world (28).

In 1911, the U.S. Supreme court forced Duke to break up his empire. The companies that emerged from the breakup were the American Tobacco Company, Lorillard, R. J. Reynolds Tobacco, and Liggett and Myers. British-American Tobacco (BAT) was also separated from American. It became a separate company,

headquartered in England, with no U. S. manufacturing or sales.

British-American stayed out of the United States market in the years following the breakup of the Duke trust, fearing reprisal from the U.S. anti-trust government forces. In 1927, BAT decided to enter the U.S. tobacco market, by purchasing Brown and Williamson, a small snuff and plug manufacturer in Winston-Salem, North Carolina. Brown and Williamson entered the domestic cigarette market in the 1930's.

Philip Morris is the only one of the Big Six with no connection to the Duke empire. It was started in London in 1847 by Philip Morris, a tobacco merchant. He began to produce specialty cigarettes in small quantities in London, and eventually began exporting to the United States. In 1919 the company was incorporated in the United States, to import cigarettes from England. It began production in the U. S. in 1934, completing the ranks of the Big Six.

Cigarettes continued to grow in popularity throughout the first half of the twentieth century because of their convenience as opposed to chewing tobacco, snuff, and pipes. Technology also played a major role in the development of the cigarette industry. The development of filter cigarettes created an upward trend in per capita consumption in the

fifties (See Figure I) Machinery was developed to manufacture and package cigarettes at very high rates of speed, giving manufacturers the capability to manufacture economically a consistent product at very high volumes.

Figure I shows that, in spite of the controversy surrounding cigarettes, per capita consumption increased in the 1970's. It began a general decline in 1982. Population and demographic conditions have tended to smooth the effect of per-capita consumption on total industry sales. Total cigarette consumption shows an increasing trend through the 1950's, until 1982 (Figure II). This was the year the Federal Excise Tax was increased from 8 to 16 cents per pack. Since 1982, taxation, social acceptability, and health issues have caused annual decreases in total industry sales.

The technology and complexity of distribution of cigarettes, mbined with the high cost of tobacco inventories, kept new mpanies from entering the cigarette business successfully. New entrants were absorbed by one of the Big Six, or went out usiness. The Big Six developed through the first half of twentieth century as a single-product oligopoly, ting only with each other, and facing few external ures (28). Very little changed in terms of the s' competitive standings in the thirties and forties. Tobacco emerged as the powerhouse from the trust and held this position into the fifties. Philip

Morris remained locked into the number six position throughout this period. See Table II.

The Diversification Era

In the mid-1950's things began to change for the industry. Cigarettes had begun to mature as a product, and the smoking-health controversy began to heat up, with the publication of the Sloan-Kettering report in 1953. This report linked smoking with health hazards. It was followed by a series of Readers' Digest articles, and by the Surgeon General's report in 1964. Since that time, the cigarette companies have been faced with increasing threats to the legitimacy of their industry due to smoking and health and social acceptability issues, and increased taxation of their product (28).

The Big Six responded to the external market forces in the 1950's. Miles breaks down the adaptation strategies of the industry into three different patterns, as shown in Table III. He classifies these strategies as Domain Defense, Domain Creation, and Domain Offense (49). The Big Six worked jointly in many respects to defend the legitimacy of their domain, cigarettes. By forming and supporting organizations such as the Tobacco Institute, they were able to function as an industry to fight off the many threats against their product.

FIGURE 1
DOMESTIC PER-CAPITA CONSUMPTION OF CIGARETTES
1950 - 1985

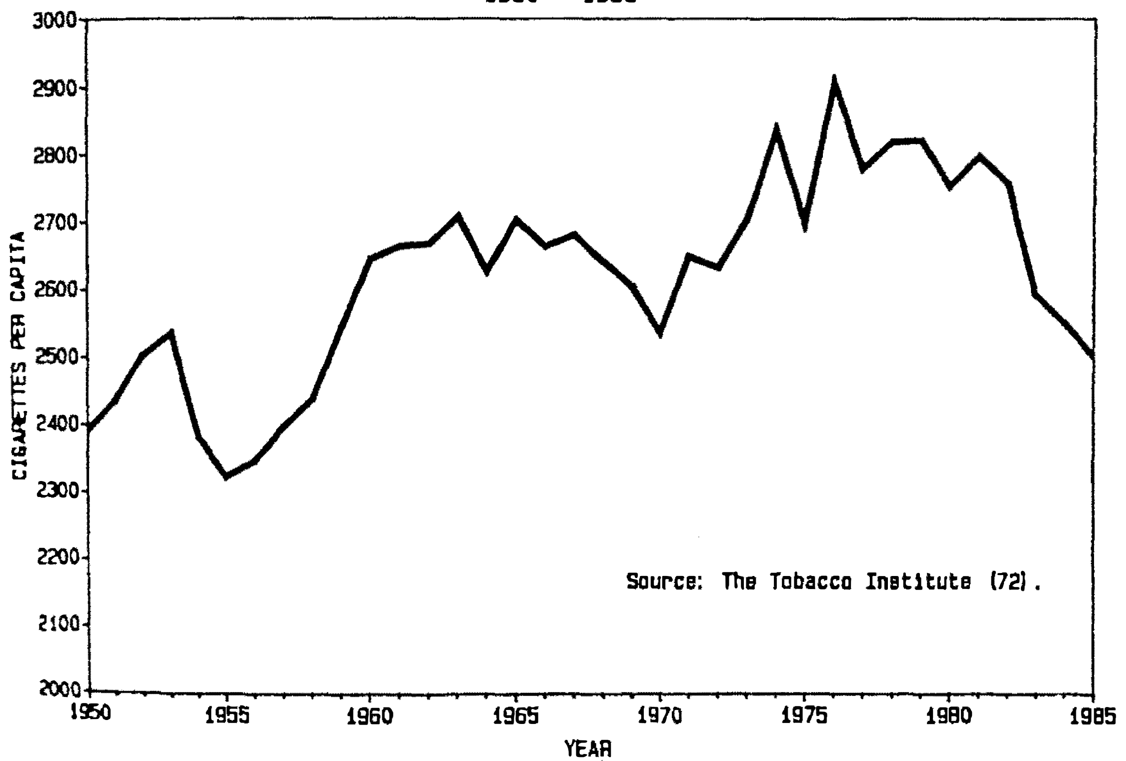
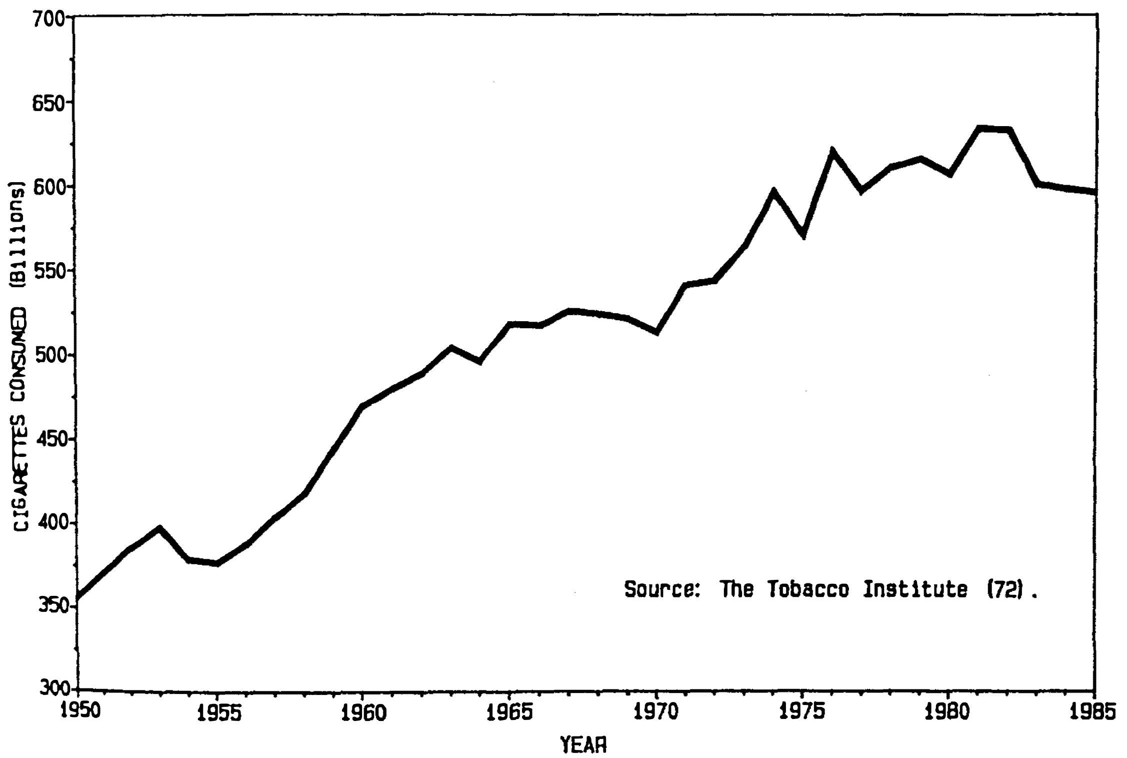


FIGURE 2
ANNUAL DOMESTIC CONSUMPTION OF CIGARETTES
1950 - 1985



-he same time that the industry pulled together to defend ., the Big Six entered into a period of fierce with each other for market share. The period ifties to the eighties has been characterized by a ber of new product introductions, to address preferences for "safer" cigarettes, such as filtered es, and low-tar, low-nicotine cigarettes. In n, the companies had to develop new marketing and sing mixes, as a result of the television advertising and the warning label requirements. The differences in cies of the companies to respond to these market changes lted in significant changes in their relative positions :he cigarette market. Philip Morris emerged from last ice in 1950 to the undisputed leader in the early eighties. erican fell from a commanding position in the industry, to very distant fifth place.

Miles analyzed the domain offense strategies of Philip Morris, American, Reynolds, and Liggett. He concluded that American's decline was due to its assumption of a "defender" role. American entered the fifties in a very solid position, with the top brands in the industry. However, it failed to recognize the need for innovation in the filtered and low-tar [illegible] categories and saw the market share of its unfiltered [illegible] disappear in favor of the competition's filtered and [illegible] brands. Philip Morris, on the other hand, assumed [illegible] of a "prospector". As the smallest of the Big Six,

it had little to lose and a lot to gain by adopting a strategy of marketing innovation, which led to the introduction of successes such as Marlboro and Merit cigarettes.

Miles characterized Reynolds as the "analyzer". Reynolds worked on two levels: one in which it protected its share of the market, and another in which it analyzed emerging trends and competitor's products, and acted quickly to capitalize on any successful innovations by competitors. This strategy worked well for Reynolds, and it achieved and held the number one position in the industry from 1950 until 1983, when Philip Morris replaced it.

Liggett was classified by Miles as a "reactor". Liggett failed to respond to the changes in the marketplace, and ended up losing market share throughout the fifties, sixties, and seventies. It did not introduce a low-tar cigarette until 1977, fourteen years after Reynolds had introduced its first low tar brand.

The relative successes of the Big Six during this period of transition is demonstrated in their respective market shares, as shown in Table II. Since there was very little price competition in the industry before the 1980's, this figure is [illegible] a good indicator of the increases in revenues of the companies.

The "domain offense" strategies of the Big Six affected their diversification strategies. As Reynolds and Philip Morris began to pull away from the pack, diversification became a necessity for companies such as American, Liggett, and Lorillard. They were seeing their cigarette volume going to Philip Morris and Reynolds, yet they were still accumulating cash which could be reinvested in other businesses. As we will see later, American was able to put together a strategy to remain in control of its future. Liggett and Lorillard were victims of acquisitions by industry outsiders.

TABLE II
DOMESTIC MARKET SHARE OF THE BIG SIX

YEAR	RJR	PM	B & W	AMER.	LOR.	L & M	OTHERS
1911				37.1	15.3	27.8	19.8
1913	0.2			35.3	22.1	34.1	9.3
1925	41.6	0.5		21.2	1.9	26.6	8.2
1930	28.6	0.4	0.2	37.6	6.9	25.0	1.5
1939	23.7	7.1	10.6	23.5	5.8	21.6	7.8
1940	21.7	9.6	7.8	29.5	5.4	20.6	5.4
1949	26.3	9.2	5.9	31.3	5.0	20.2	2.1
1955	25.8	8.5	10.5	32.9	6.1	15.6	
1960	32.1	9.4	10.4	26.1	10.6	11.3	
1965	32.6	10.5	13.3	25.7	9.2	8.7	
1970	31.8	16.8	16.9	19.3	8.7	6.5	
1971	31.8	18.2	16.8	17.8	9.2	6.2	
1972	31.4	20.0	17.3	16.8	8.9	5.6	
1973	31.3	21.8	17.6	15.7	8.4	5.1	
1974	31.5	23.0	17.5	15.0	8.2	4.7	
1975	32.5	23.8	17.0	14.2	7.9	4.4	
1976	33.2	25.2	16.5	13.4	7.8	3.9	
1977	33.1	26.7	15.8	12.3	8.7	3.6	
1978	32.9	27.9	15.3	11.6	9.0	3.2	
1979	32.7	29.0	14.5	11.5	9.6	2.7	
1980	32.8	30.8	13.7	10.7	9.8	2.2	
1981	33.0	31.8	14.0	9.5	9.2	2.5	
1982	33.4	32.8	13.3	8.9	8.7	2.9	
1983	31.5	34.4	11.5	8.6	9.2	4.8	
1984	31.6	35.3	11.3	8.2	7.9	5.7	
1985	31.6	35.9	11.9	8.1	7.5	5.0	
1986	32.4	36.8	11.5	8.1	7.2	4.0	

Legend:

RJR = R. J. Reynolds
PM = Philip Morris
B & W = Brown and Williamson
AMER. = American
LOR. = Lorillard
L & M = Liggett and Myers

TABLE III

PATTERNS OF STRATEGIC ADAPTATION AMONG THE BIG SIX

ADAPTIVE MODES	GOALS	STRATEGIES	REFERENT DOMAIN	TARGET	RELATIONS AMONG TRADITIONAL COMPETITORS
Domain Defense	Preservation of legitimacy and autonomy of traditional domain (LEGITIMACY)	Creation and control of vital information Lobbying and coopting institutional gatekeepers	Traditional product/market	Agents in the institutional environment surrounding the traditional product/market	Cooperative
Domain Offense	Enhancement of economic performance in traditional domain (EFFICIENCY)	Product inovation Market segmentation	Traditional product/market	Rivals for the traditional product/market	Competitive
Domain Creation	Creation of new performance opportunities; minimization of risk exposure (GROWTH & SECURITY)	Diversification Overseas expansion	New products & markets	Rivals for the new products/markets	Independent

Source: Miles, Coffin Nails and Corporate Strategies, (49, pg. 51).

CHAPTER III

DIVERSIFICATION STRATEGIES

Background

Before analyzing the diversification strategies of the Big Six, it is important to review the background for the development of modern-day conglomerate corporations. The Big Six are atypical companies, from the standpoint that they grew to very large sizes as single-product companies in an oligopoly. However, from a more general viewpoint, they were part of the overall development of modern-day corporations, and there is very little doubt that they would have diversified whether there had been a smoking-health controversy or not.

American business has seen three waves of merger and diversification in the twentieth century (49, 23). Each wave coincided with an expansion period in the economy. The first of these occurred during the period 1898 to 1902. This was prior to the days of anti-trust legislation, and Miles refers to this period as "merging for monopoly" (49). It was during this period that many corporations were able to establish themselves as major forces in their product line, by [illegible] other companies. Duke was able to consolidate his

tobacco empire during this time, absorbing sixteen other companies along the way.

The second wave of merger and acquisition occurred during 1925-1931. Miles calls this period as "merging for oligopoly". During this period, companies tended to consolidate their positions through vertical and horizontal integration of their product lines.

The third wave described by Miles is the period 1955-1970. Miles refers to this period as "merging for growth". Companies which had established themselves in a particular business line had to look for growth opportunities elsewhere, because anti-trust legislation kept them from acquiring direct competitors, or the growth oportunities in their own markets had slowed down. It was during this third wave that the tobacco companies developed their strategies and began their diversification programs. As we shall see, some of the [illegible] six put together formal diversification programs in the [illegible]'s, while others tended to resist major diversification until well into the 1960's.

[illegible]richsen reviewed the development of diversified [illegible]rate firms from 1920-1970 in the <u>Business History</u> [illegible]. He refers to three stages of corporate growth:

[illegible] "Stage I" firm is the informally organized, single [illegible] single product company. The "Stage II" firm is

> functionally organized and integrated, and produces a single product line. The "Stage III" firm is the diversified, multidivisional company. Scott's thesis is that as firms grow and mature they tend to move from Stage I through II and into III.
>
> The diversifed firm is specifically distinguished from the integrated firmn by a pattern of direct transactions between the product market sub-units and the market place. In the fully integrated firm only the last subunit in the production chain offers the finished product for sale (23, pp. 205-206).

By the 1950's, all of the Big Six had progressed from Stage I to Stage II, and were ready to progress into Stage III.

General Diversification Strategies

Didrichsen identifies four general diversification strategies followed by firms since the 1920's. They are internal development, acquired technology, homogeneous markets, and conglomerate strategies.

[illegible]ernal development usually involves little or no detailed [illegible]g term planning. Growth essentially comes through throw-[illegible] from internal research activities which lead the company [illegible] new product areas. Didrichsen uses Dupont as an example [illegible] company that "developed an extensive competence in a [illegible] technology through internal development".

[illegible]ed technology is a strategy by which companies [illegible]ify through acquisition of companies which can [illegible]ment their technology. Companies following this

strategy will ususally diversify by acquiring companies in a related product line, with a technology base that complements the acquirer's technology. An example of this is White Consolidated Industries, which expanded in the 1950's from a sewing machine company into industrial machinery and consumer appliances, by acquiring a number of companies in those product lines.

Homogeneous market strategies involve diversification by acquisition of companies with product lines that utilize similar channels of distribution. The key ingredient in this strategy is a similarity in marketing and sales skills needed to market the acquired company's product lines. As we shall see later, American Tobacco utilized this strategy extensively as it diversified into consumer products with distribution systems similar to cigarettes.

Companies using conglomerate strategies extend their activities into unrelated product areas, for defensive or offensive reasons. A key reason for this type of strategy is to spread risk among several industry and product categories. Companies utilizing this strategy usually organize into a "holding company" structure, with relatively autonomous sub-units reporting to a corporate unit. A classic example of this strategy is ITT, which went into numerous unrelated businesses in the sixties, including communications, utilities, and financial services.

Diversification Strategies of the Big Six

The Big Six utilized all of the strategies outlined above at different times during their diversification histories. In the next chapter, we will see how these strategies, developed and implemented in the 1950's 60's and 70's, impacted the corporations we have in the 80's. In the following sections, we will look at how each of the Big Six instituted its own diversification strategy, and how it entered the eighties. We will see that two of the Big Six didn't make it into the eighties as conglomerates - Liggett and Lorillard were absorbed along the way. We will also see how Philip Morris, American, and Reynolds applied their own diversification philosophies, learned from mistakes along the way, and emerged into the 80's as conglomerate corporations.

R. J. REYNOLDS

1954 - 1979

Reynolds began its diversification in the late 1950's with an internal development move. It had previously set up its [illegible] Aluminum division in a vertical integration step, to supply foil for its packaging operations. As its first step [illegible] diversification, it expanded the Archer division to supply [illegible] to meet the growing demand for consumer packaging and [illegible] materials.

Reynolds approached diversification in a very formal and systematic manner. It organized a diversification task force which evaluated potential acquisitions, and developed a formal set of diversification targets and criteria for the corporation. The primary goal of its diversification strategy was profit protection (49)

In the 1960's Reynolds began its major diversification moves, with purchases of several consumer goods companies It purchased Pacific Hawaiian Products, makers of Hawaiian Punch, in 1963. This purchase was followed in 1966 by the purchases of Penick and Ford, Chun King, and Filler Products, Inc., all food-related businesses. Nineteen sixty-seven was another major acquisition year, with the purchases of Patio Foods, Coronation Foods, and Filmco. Filmco was purchased as an extension of the foil business of the Archer Division.

Throughout the first part of the sixties, Reynolds' acquisitions were minor compared to its investments in manufacturing capacity for its filter cigarettes. Reynolds had become the number one cigarette manufacturer in the United States, and was making investments to protect that position. In the late 1960's the strategy changed. Reynolds began to invest towards expansion of its international cigarette business, and it also began to make very major investments in unrelated industries.

The first unrelated investment came in 1969, with the purchase of McLean Industries. McLean was in the transportation industry, and was owner of Sea-Land, the largest containerized sea-freight service in the world. Reynolds saw this investment as an opportunity to get in on a new industry with high growth potential.

The purchase of McLean made the non-tobacco businesses a significant share of corporate revenues. In 1969 Reynolds acknowledged this fact by changing its name from R. J. Reynolds Tobacco Company to R. J. Reynolds Industries.

Reynolds continued the conglomerate diversification strategy in the 70's. It purchased American Independent Oil Company (AMINOIL) in 1970. The reasoning behind the purchase of AMINOIL was two-fold. First, Reynolds was looking for growth opportunities in the energy industry, and it also was looking for a stable supply of oil for its shipping subsidiary, Sea-Land.

The implementation of Reynolds' diversification in the sixties and early seventies created some uneasiness in the stockholders' minds. The company had not only used the resources provided by tobacco, but had also incurred a high debt ($ 100 million in 1971) to pay for the McLean and AMINOIL purchases. The ventures into unrelated businesses

did not go very well at the beginning, as reported by Finger (28):

> None of the food subsidiaries had a nationally leading brand name, making the promotion job tougher and cutting into profits significantly. A major dock strike in 1971 crippled Sea-Land, and the blocked purchase of U.S. Lines thwarted the company's long range plans. AMINOIL did not produce stellar earnings figures either. And Reynolds' share of the domestic cigarette market slipped slightly, from 31.8 percent in 1970 to 31.5 percent in 1974.
>
> These woes prompted some mutinous grousings from Reynolds' largest block of stockholders, the Reynolds family. As quoted in Forbes, one family member snapped, "Look, these guys are the world's best at marketing and selling tobacco products, but what do they know about ships or oil?"

[illegible]e of this dissatisfaction was addressed when a new [illegible]agement team took over in 1973. This team was led by [illegible]n Stokes, who had come up through the company's tobacco [illegible]ness, and would hopefully turn back the slide in [illegible]ette market share. However, Paul Sticht, a vice-[illegible]dent who had a non-tobacco marketing background, became [illegible]werful force in the company. He became chairman in [illegible]nd for the first time in the history of the company a [illegible]acco person was in charge of the corporation. Sticht [illegible]ed an aggressive program to pump tobacco profits into [illegible]any's other subsidiaries.

[illegible]made one more major purchase in the 70's. In 1979 [illegible]ased del Monte (a canned fruit and vegetable [illegible] for 618 million dollars, and began plans to

consolidated all its food product operations under one subsidiary, RJR Foods. Del Monte represented a retrenchment back into more familiar consumer product lines.

As the 70's closed out, the verdict was still very much in doubt on the success of Reynolds' diversification strategy. The acquired businesses had performed at lower levels than anticipated, and the cigarette business was steadily losing market share to Philip Morris.

Cigarettes were still Reynolds' most profitable product however, and as the 1970's ended Reynolds reaffirmed its commitment to this business by announcing a one billion dollar expansion program for its cigarette operations, to support domestic and international markets.

1979 - 1987

In 1984, Reynolds sold its energy businesses, and began its move to consolidate its markets into consumer product lines. The acquisition of Nabisco foods in 1985 was a major step in achieving this objective.

The purchase of Nabisco resulted in the first year in which non-tobacco sales exceeded tobacco sales. To highlight this fact, the company changed its name to RJR-Nabisco. In its

1985 annual report, the company's management stated its diversification objectives as follows:

1. Achieving a more balanced portfolio, from a profit contribution perspective.
2. Protecting and enhancing the corporation's competitive position in the consolidating food and beverage industry.
3. Securing new sources of business growth.
4. Achieving an international presence.
5. Enhancing management depth.

To achieve these objectives, the company made a series of divestitures and consolidations after the purchase of Nabisco. RJR-Nabisco sold off its interests in the restaurant and food services industries when it sold Kentucky Fried Chicken and Service Systems Corporation. It also sold the Skolnik Bagel Bakeries and Dental Care of America subsidiaries. And, in a major divestiture move, RJR-Nabisco sold off its wine and spirits subsidiary, Heublein, for 1.2 billion dollars in 1987.

RJR-Nabisco also made consolidation moves in the tobacco industry, when it sold most of its chewing tobacco brands and discontinued sales of the others. This left RJR-Nabisco's domestic tobacco operations with only cigarettes and small cigarillos.

In the food business, RJR-Nabisco combined the operations of Del Monte and Nabisco, in order to take advantage of the synergies between the two companies.

The merger of RJR and Nabisco also brought major changes in the management structure of R. J.Reynolds. F. Ross Johnson, the chairman of Nabisco, became chief executive officer of RJR-Nabisco soon after the acquisition of Nabisco by R. J. Reynolds. Within three weeks of assuming the position, Mr. Johnson announced the relocation of corporate headquarters from Winston-Salem to Atlanta. Part of the reason for the move was to distance the corporate headquarters from the tobacco-centered activities in Winston-Salem, that is, to emphasize the diversified nature of the new RJR-Nabisco (74). In addition, the move was combined with a reduction in corporate staff from 1,000 to 300, a further move towards streamlining and consolidation of the company. With the merger, RJR-Nabisco has become a true conglomerate, led by a non-tobacco chief executive (43).

PHILIP MORRIS

1954 - 1979

Philip Morris was committed to domain offense more than any other of the Big Six and aggressively pursued cigarette market shares in the U.S. and market opportunities

internationally. The growth of its cigarette business, beginning in 1955, kept Philip Morris' attention focused on facility expansions and marketing efforts domestically and internationally.

However, success in cigarettes did not make Philip Morris lose sight of the opportunities and the need for diversification. It set up a corporate planning department in the early 1960's and continued a steady strategy of acquisition and expansion, using cash generated by the tobacco business (26). In 1960, Philip Morris purchased the American Safety Razor Company. This was the beginning of a more planned strategy, in which Philip Morris was interested in product lines with similar marketing and distribution systems, and low per-unit costs. American Safety Razor was followed by the acquisitions of Burma Shave and Clark Gum in 1963 (28).

In the 50's and early 60's Philip Morris' acquisitions were almost insignificant in relation to its tobacco business. [illegible], in 1968, Philip Morris made a major move by purchasing [illegible] percent of the Miller Brewing Company. In 1970 it purchased the remaining 47 percent, to make Miller a wholly owned subsidiary.

Miller met most of Philip Morris' criteria for acquisition. It had a low market share in a large market, and had

potential for the type of growth Philip Morris desired. Philip Morris immediately began to pour resources into Miller, in the form of marketing management skills and cash to build new breweries. By the end of the 1970's, Miller had gone from number seven to number two in the beer industry (28)

Philip Morris continued its expansion in the seventies. In 1970 it purchased Mission Viejo, a real estate development company in the west. Mission Viejo represented a business line totally unrelated to the company's other businesses, and was purchased strictly as a financial investment.

In 1970 Philip Morris also bought Plainwell Paper and Armstrong Products. These two companies were rolled into the Industrial division, which already included Nicolet and Milprint. In 1971, it purchased Lindeman Holdings, an Australian wine company. Wisconsin Tissue Mills was added to the Industrial division in 1977.

Another major acquisition was made in 1978, when Seven-Up Company was purchased. Seven-up was the third leading soft-drink company in the United States, and also included some food subsidiaries and an international division. Philip Morris hoped to have the same success with Seven-Up that it had with Miller, making it into a direct contender with industry leaders Pepsi and Coca-Cola. Philip Morris

immediately began to pour the marketing and capital resources into Seven-Up, but, as we shall see later, the marketing magic did not rub off on Seven-Up (25)

By the end of the 70's, Philip Morris had developed into a major force in the cigarette industry, threatening Reynolds for the number one spot domestically. More significantly, it had made a secure place for itself in the international cigarette market, expanding through acquisitions, licensing agreements, and new manufacturing facilities into more than 140 countries. The international division had been made into a free-standing subsidiary, a counterpart to Philip Morris U.S.A.

At the close of the 1970's Philip Morris Incorporated consisted of six operating companies: Philip Morris USA, Philip Morris International, Miller Brewing Company, Seven-Up, Philip Morris Industrial, and Mission Viejo. Philip Morris had learned some important lessons along the way. Its Clark Gum and American Safety Razor acquisitions failed to meet the company's growth and profit expectations and were divested. Miller Brewing, a great marketing success of the 70's, had not come close to making a return on the investment that Philip Morris had made. So, Philip Morris entered the 80's as a successful, diversified company, but still relying overwhelmingly on profits from cigarettes for its earnings.

1979 - 1987

In 1986, Philip Morris reached a milestone in its diversification history. For the first time, revenues from tobacco were less than half of corporate revenues, although tobacco still dominated the profit picture, with almost 75 percent of operating income coming from tobacco (54).

The early 1980's were relatively stable years for Philip Morris in terms of diversification. The company invested its money and management resources in trying to spur the growth of Miller Brewing and the newly acquired Seven-Up company. In addition, it invested heavily to support its growth in the domestic and international cigarette businesses. However, by the end of 1984 it was clear that growth in the beer market would be difficult to achieve, and that success in the soft drink market would also be very difficult. Philip Morris, although dominant in the cigarette market, had run into formidable competition from Anheuser-Busch, Pepsi, and Coca-Cola.

In 1985 and 1986 Philip Morris made a series of divestitures and acquisitions, and emerged as a multi-company conglomerate, with 1986 revenues being almost double the 1984 revenues. The company reverted back to its strengths in marketing consumer products, by selling off most of its Philip Morris Industrial units, including Wisconsin Tissue

Mills, Nicolet Paper, and Plainwell Paper. The industrial unit had always been a minor portion of corporate revenues (less than 10 percent), and did not fit in with the company's business plans.

The divestiture of Philip Morris Industrial was followed closely by the largest acquisition in Philip Morris history, and one of the largest corporate mergers on record. In acquiring the General Foods Corporation, Philip Morris almost doubled in size (as measured by sales revenues). General Foods was purchased for 6.5 billion dollars in November of 1985, shortly after the merger of Nabisco-R. J. Reynolds.

Only a few months after the General Foods merger, Philip Morris announced the sale of the Seven-Up company. Seven-up had not been able to strengthen its third-place position in the soft drink industry, and in fact had been slipping in market share compared to Coke, Pepsi, and Dr. Pepper. In addition, it had been unable to position a cola drink in the market to compete effectively with the much larger Coke and Pepsi.

Nineteen eighty six was a consolidation year for Philip Morris, as the General Foods subsidiary was absorbed into the Philip Morris family of companies. Shortly before acquiring General Foods, Philip Morris had reorganized into a holding company structure. The following companies were set up as

subsidiaries under the parent Philip Morris Companies Incorporated:

Philip Morris USA (Tobacco)
Philip Morris International (Tobacco, wine)
Miller Brewing Company
General Foods Corporation
Mission Viejo (Real Estate Development)
Philip Morris Credit Corporation (Financial Services)

AMERICAN

1954 - 1979

American Tobacco began as the original major tobacco company, the corporate parent of the James Duke tobacco trust. Yet, it finished the 1970's as the most diversified of the big six that survived as corporate entities. Since 1911, when the Duke trust was broken up, American was the industry leader in the domestic cigarette market. Perhaps because of its dominant position, it failed to recognize the need to change when the market demanded filtered and low tar cigarettes.

The decline of American's cigarette market began in the mid-fifties, when companies like Reynolds and Philip Morris introduced filter cigarettes. American failed to jump on the bandwagon, and by 1958 Reynolds had replaced it as the number one cigarette manufacturer. American essentially slept through the 1950's and early 60's. In 1964 it was still

relying on non-filter cigarettes for the bulk of its sales, and had not made any significant diversification moves.

New management recognized the problems in 1964, and responded on both the domain offense and domain creation fronts. They instituted a series of new cigarette brand introductions in the filter and low-tar categories. It was during this period that Carlton cigarettes were introduced, now one of the most successful low-tar cigarettes. In 1966 and 67, the company went on a buying spree, purchasing Sunshine Biscuits, James Beam Distilling, Swingline Stapler, Acme Visible Records, Master Lock, Duff-Mott (applesauce), and Andrew Jergens (personal care products) (28).

The basic thrust of American's late but aggressive diversification was in consumer products, requiring heavy marketing. Unlike Philip Morris and Reynolds, American did not venture far from the basic distribution and marketing strengths it had in the cigarette business. In 1969, American affirmed its status as a diversified corporation by changing its name from American Tobacco to American Brands.

Two major non-tobacco acquisitions followed in the 1970's. In 1973, American bought Acushnet Company, and in 1979 it completed the acquisition of the Franklin Life Insurance Company. The insurance company acquisition was its first move from consumer products, and it proved very successful.

In its first year as a wholly owned subsidiary it, provided 100 million dollars in income to the parent company.

Like Philip Morris, American elected to expand its domain in the cigarette business through international expansion. In 1968 it bought a 75 percent interest in Gallaher Limited, Britain's second largest cigarette manufacturer. It obtained full ownership of Gallaher in 1975. The Gallaher acquisition gave American an international presence, with the opportunity to use the distribution and marketing resources for other consumer products, and for the export of domestic cigarettes. The Gallaher subsidiary itself became a diversified company, with 25 percent of its profits coming from non-tobacco businesses by the end of the 1970's.

American's strategy in the 1970's appeared to be one of pure diversification away from cigarettes. It was putting little investment back into the cigarette business, and introducing few new brands. In the meantime it was utilizing its tobacco-generated cash to support and expand its non-tobacco businesses. Its share of the domestic cigarette market went from 32.9 percent in 1955 to 14.2 percent in 1975, and to 11.6 percent in 1979. By 1975, the majority of its cigarette sales income was coming from the Gallaher subsidiary, not the domestic producer.

1979 - 1987

American has continued the diversification strategy formulated in the late 60's and early 70's. In 1979, American Brands consisted of the following divisions and subsidiaries:

The American Tobacco Company
American Cigar
Gallaher Limited
Franklin Life Insurance Company
Master Lock Company
Wilson Jones Company
Swingline Incorporated
Sunshine Biscuits
Acushnet
The Andrew Jergens Company
Acme Visible Records
W. R. Case & Sons Cutlery
Duffy-Mott Company Inc.

American Tobacco and American Cigar were operated as divisions of American Brands, whereas the other companies were subsidiaries.

By 1979, American had aligned itself around four "core businesses", which included domestic tobacco, financial services, domestic manufacturing, and international products through the Gallaher subsidiary (3). In the manufacturing sector, American continued to concentrate on manufacturing of high-volume packaged products, with low per-unit prices. It is interesting to note that American did not identify one of its core businesses as food products, although it had

Sunshine Biscuits and Duffy-Mott in its family of companies. Apparently its long-term strategy was to become a true conglomerate, with no close corporate identification with a specific product. This "acquisitive conglomerate" strategy became more evident by 1986. In its 1986 annual report, American describes itself as a "broad-based worldwide holding company strongly positioned in two core businesses, packaged consumer goods, and financial services." The corporate identification with tobacco had completely disappeared. In October 1987, American sold off the Sunshine Biscuits subsidiary.

Edward Whittemore, who replaced Mr. Robert Heimann as chief executive officer in 1980, has been the chief architect of American's diversification strategy in the 1980's. Mr. Whittemore came from the company's Wilson Jones subsidiary, and under his leadership American has distanced itself even more from the "tobacco company" image (30) In January 1986, the company changed to a holding company structure, making American Tobacco a subsidiary company, as opposed to a division of the corporation.

American has made the following major acquisitions since 1979:

1981: Purchased Offrex, a British office products company, through British subsidiary Gallaher.

1983: Purchased Pinkerton's, a major security and investigations firm.
Gallaher acquired the largest optical company in Spain, and Eastlight Limited, a British office supplies company.

1984: Franklin Life Insurance acquired Southland Life Insurance Company.
Gallaher acquired The Prestige Group, PLC, a manufacturer of houseware products in the United Kingdom.

1985: Acushnet acquired Foot-Joy Incorporated, a manufacturer of sports footwear and gloves.
Master Lock acquired Dexter Lock Company, manufacturer of door lock sets and door hardware.

1986: Acquired Bonny Products, Incorporated, manufacturer of kitchen utensils, and added it to the hardware group.
Pinkerton's acquired BASIX Controls Systems Corporation, a business specializing in security systems.

1987: Acquired ACCO World, office supply company.
James Beam acquired the distilled spirits business of National Distillers and Chemical Corporation.

As shown above, American's strategy in the 1980's has been to build up the business lines that it established in the first fourteen years of its diversification program (1966-1979). In most cases, acquisitions were made by the subsidiary companies, and were made for the purpose of increasing American's presence in the given markets. Throughout its history of diversification, American's approach has been to acquire companies for growth and investment value. Its management strategy has been to leave existing management in place and allow the subsidiaries to function independently as long as the income growth meets corporate requirements.

American has pursued international as well as domestic diversification. Its Gallaher subsidiary is itself a diversified company, with interests in optical products, food products, and liquor as well as its traditional tobacco business. Gallaher's acquisitions have tended to follow the same general trend as its parent company, with major acquisitions in office products, housewares and hardware, and optical products.

American's domestic tobacco businesses have been on a steady decline through the 1980's. However, profits from domestic cigarette sales have remained very healthy, and the company has been unwilling to totally abandon its cigarette business. In 1982, American re-introduced its Lucky Strikes brand, in a filtered version. The brand has enjoyed a mild success, thanks to its well-recognized name. The re-introduction of Luckies has helped American slow down the erosion of its cigarette market shares (30). But in 1983 American slipped below Lorillard in the rankings of the "Big Six" manufacturers, to fifth place.

American's commitment to tobacco did not extend into the cigar business. In July of 1986, American sold its American Cigar subsidiary, stating in its 1986 annual report that the cigar business did not "fit long term strategic growth plans" (5).

Unlike American's domestic cigarette business, its foreign cigarette sales continued a pattern of slow growth in spite formidable obstacles posed by a declining, and tax burdened British market Gallaher's cigarette volume increased in 1986, despite a three percent decrease in British market volume. Its share of the British cigarette market was 35 percent in 1986, second in the industry. Gallaher is also well poised for cigarette sales volume growth in European and Middle East markets.

American today is a totally different corporation than the tobacco giant of the thirties and forties. Its story differs considerably from any of the other Big Six. Unlike Philip Morris and Reynolds, it has performed poorly in its traditional cigarette business, missing key marketing opportunities along the way. However, unlike Liggett and Lorillard, it has been able to control its own destiny and has emerged as a leading multinational consumer products and financial services company. Its strategy of diversification through acquisition of smaller companies has worked well through the years. Since 1966, American has invested more than three billion dollars in diversifying acquisitions (5).

Even after its twenty-year diversification process, American still owes most of its income to tobacco. In 1986, 61 percent of sales and 59 percent of operating profits came from tobacco (5). All indications are that American will

continue its pattern of acquisitions, to further dilute its reliance on tobacco products. In 1986 it attempted a major expansion by bidding for the Cheeseborough-Ponds company. However, it was defeated by Unilever, which offered more for Cheeseborough-Ponds. In 1987, American acquired ACCO World, an office products company, which will almost double American's size in this market (37).

LORILLARD

1954 - 1979

Like American, Lorillard failed to react effectively to market changes in the 1950's. American was able to recover and institute an aggressive diversification strategy. Lorillard was not so lucky. It made some attempts at diversification in the 1960's, by purchasing a pet food company and two candy companies. But, the execution of its diversification attempts was poor, and in 1967 its non-tobacco businesses accounted for only five percent of total sales. Lorillard's cash flow and small size compared to the other Big Six made it a good takeover candidate. In 1968, Laurence Tisch's Loews Theatres absorbed Lorillard. At that time Loews was a 137 million dollar per year company, and Lorillard was a 567 million dollar per year company. Tisch changed the name of the company from Loews Theatres to the Loews Corporation the following year, and immediately set

about to look for investment opportunities from the Lorillard-generated cash.

Tisch applied Lorillard's cash flow towards expansion of Loews' hotel business, but his primary interests were in stock market activities. He utilized the cash in a string of unsuccessful acquisition attempts, including Goodrich, RCA, Franklin National Bank, Gimbel's Department Stores, and Talcott National Corporation.

Loews protected its cash-generating subsidiary. Tisch brought in new management for Lorillard, including a new chairman, Curtis Judge, who had been a Reynolds Vice-President. Judge streamlined the company's marketing functions, upgraded the manufacturing facilities, and was able to increase cigarette volume by 25 percent in the last half of the 1970's while the total industry was stagnant. This compares with a loss in volume in the 1960's, from 49.8 billion cigarettes in 1960 to 46.5 billion in 1969 (28).

But Lorillard's primary role continued to be as Loews' cash cow. In 1974 Loews began a phased purchase of CNA Financial Corporation, which had been financially troubled. The same pattern was repeated in 1979, when Loews purchased the ailing Bulova watch company (50). By now Tisch's pattern was clear. Lorillard was to play a cash-generating role in his acquisition strategy, which consisted of purchasing

financially strapped companies and effecting a turn-around through management house-cleaning and infusion of cash. When Loews purchased Lorillard, the cigarette company was a major portion of the new corporation. Then, as Loews continued its diversification, Lorillard became a smaller player in the conglomerate company. By 1979, Lorillard only accounted for 23 percent of Loews' revenues, and 22 percent of its income.

Unlike American, Reynolds, and Philip Morris, Loews had no interest in expanding its tobacco business overseas. In a strategic move that differed greatly from the others, Lorillard divested of its international cigarette brands by selling them to British American Tobacco in 1977 (11).

1979 - 1987

In 1979, Loews Corporation was a holding company for the following companies (40):

CNA Financial Corporation
Loews' Theatres
Loews' Hotels
General Finance Corporation
Lorillard Division
Bulova Watch Company

Loews had been increasing its holdings in the CNA Corporation since 1974, and by 1979 owned 84 percent of the company. CNA accounted for 65 percent of Loews' revenues in 1980, compared to Lorillard's 23.22 percent. In 1981, Loews' bought back 90

million dollars of its own stock. It also increased its' ownership of CNA to 90 percent.

The Tisch brothers continued to operate Loews as an investment vessel, with numerous acquisitions of blocks of shares in other companies. Their ownership of Loews reached 50 percent of total capitalization in 1981, as a result of stock buy-backs. During 1980-81, Loews purchased 5.22 percent of General Foods common stock, then decreased its holding of General Foods to 4.6 percent. It also purchased significant blocks of Firestone stock. Other significant financial activities by Loews during this period include the sales of several major hotels, including the Drake Hotel in New York, which was sold for 73.5 million dollars in 1981.

During the early 1980's, Lorillard continued to provide increasing sales and earnings despite slippage in its share of the domestic cigarette market. Lorillard accomplished the increases in earnings through price increases and reductions in advertising and operating costs. In 1982, Lorillard was able to achieve record revenues and earnings of $1.2 billion and $229 million respectively, although its share of the cigarette market dropped from 9.3 percent to 8.8 percent.

Lorillard was able to recover some of its lost market share in 1983, and completed the year with a 9.1 percent market share. The rebound was largely due to the success of its

Newport brand. However, in 1984 Lorillard ran into hard times again, losing almost one percent of the market (from 9.1 to 8.2). Its unit sales of cigarettes dropped 9.9 percent, and cigarette revenues decreased by 3.9 percent. This news began to stir rumors of a possible sale of the cigarette company by the Tisch brothers (39). Since 1984, Lorillard's share of the cigarette market has stabilized at 8.1 percent, although unit sales have decreased by about one billion units per year, reflecting decreases in the market.

The rumors of the sale of Lorillard turned out not to be true, but in 1985 Loews did make a major strategic move by selling off its original business, Loews Theatres, for an after-tax gain of $80.8 million . This sale had the effect of concentrating the company's income stream into two major sources: Lorillard and CNA Financial. Lorillard represented 22.4 percent of Loews total revenues in 1985, and CNA represented 71 percent of total revenue. The earnings picture was different: Lorillard provided 32 percent of operating income, while CNA provided 50 percent. In addition to the operating companies, Loews had a stock portfolio of over $600 million, under the direction of the Tisch brothers, who owned 32 percent of the company's stock (the Tisch's had reduced their ownership of Loews' stock from a high of 50 percent in 1981).

In 1985 Loews also began a major strategic acquisition which made headlines for many months. Under Lawrence Tisch's guidance, Loews purchased approximately 5 five percent of CBS common stock (1.3 million shares), and 1 million shares of ABC common stock. The total investment in the two broadcasting companies reached $250 million. At the time, CBS was involved in an unfriendly takeover battle with Turner Broadcasting Company, and Lawrence Tisch saw the investment potential of owning a sizable share of CBS stock, which he felt was undervalued and would rise rapidly as a result of the takeover battle.

By October of 1985, Loews had increased its share of CBS stock to 11.1 percent, and Tisch announced his intention of increasing Loews' ownership of CBS to 25 percent. Loews' acquisitions of CBS stock were seen as a more acceptable course by CBS than a takeover by Turner Broadcasting. In November of 1985 Tisch was invited to join the board of CBS (1).

Loews continued its purchase of CBS stock into 1986, and by August of 1986 its ownership of CBS reached 24.9 percent. In order to resolve management problems at CBS, Lawrence Tisch became its Chief Executive Officer in September of 1986. Loews announced that it would begin including a portion of CBS's profits in Loews' earnings starting in the second half

of 1986, and indications were that the two companies were headed for a consolidation at some point in the future.

LIGGETT

1954 - 1979

The story of Liggett and Myers was bluntly summarized by James Overton in The Tobacco Industry in Transition (28). Overton writes:

> Among all corporations, Liggett and Myers Tobacco Company has to rate as one of the great business failures of the post-World War II era. From a strong position as one of the industry's Big Three (with American Tobacco and R. J. Reynolds) in 1946, Liggett and Myers fell to last place among the Big Six producers in 1962 and has steadily declined since then, netting a dismal 2.7 percent of industry sales in 1979. New brand introductions in the 100-millimeter and low-tar markets have been busts, and the company has not even developed a strong filter entry.

Liggett's strong suit during the early years of the industry was its manufacturing orientation (49). Along with Lorillard and American, it also failed to recognize the market changes in the 1950's. Lorillard and American were able to retard the slippage somewhat once they recognized the market changes. Liggett and Myers went into a tailspin, from which it did not recover. Cigarette sales went from 51.2 billion units in 1960 to 16.5 billion units in 1979.

For Liggett, diversification was a matter of survival. It became the first of the Big Six to be a "diversified company", but only because its cigarette business was in such a decline that it didn't take long for its non-tobacco acquisitions to achieve a prominent role in the company.

Liggett and Myers began diversification with a strategy of purchasing product lines which required a high degree of consumer marketing effort. It began in 1964, well after Philip Morris and Reynolds, with the acquisition of Allen Products, manufacturers of Alpo Dog Food. In 1966 it bought the Paddington Corporation, and Carillon Importers, both importers of liquors. It continued with these two basic expansion lines by purchasing two more pet food companies in 1969, Liv-A-Snaps and Perk Foods, and another liquor company, Austin, Nichols.

Liggett and Myers also made a number of small acquisitions in the late 1960's, such as National Oats Company, Brite Industries (watch bands), and Earl Grissmer Company (home-care products).

In 1974, Raymond Mulligan became chief executive officer. Mulligan came from the Allen Products subsidiary, and represented the first non-tobacco chief executive. The company name was changed from Liggett and Myers Tobacco to the Liggett Group (28).

Liggett made two other acquisitions in 1979, before it became the target of a takeover. It purchased the Atlantic Soft Drink Company, the nation's largest soft drink distributor, and Diversified Products, a sporting goods company.

Liggett's diversification was quite evident at the end of he 1970's. In 1979, non-tobacco business was 65 percent of revenue and 71 percent of operating income. However, its dismal performance in the cigarette industry kept its size small enough to make it susceptible to a takeover. In fact, at several points in the 1970's, Liggett had attempted to sell its tobacco operations, to make itself more attractive for a potential suitor. Several potential buyers surfaced, but were scared off when they discovered the amount of cash resources that would be required to make Liggett's tobacco business competitive again (21).

1979 - 1987

Unlike the other Big Six, Liggett did not have the huge tobacco profits to rely on throughout its diversification era. Instead, Liggett saw its cigarette unit sales and market share erode precipitously. By 1979, Liggett's share of the domestic cigarette market was a paltry 2.8 percent, and it had already sold its international cigarette business to Philip Morris in 1978.

The Liggett Group in 1979 was composed of the following companies:

Liggett and Myers Tobacco Company
Pinkerton Tobacco Company (chewing and pipe tobacco)
Paddington Corporation
Austin, Nichols & Co.
Carillon Importers
Allen Products Co.
Atlantic Soft Drink Co.
Diversified Products Co.
Earl Grissmer Co.

Liggett relocated its corporate headquarters from Durham, North Carolina to Montvale, New Jersey in 1979, when it changed its name to The Liggett Group. After completion of the sale of its international cigarette business to Philip Morris, Liggett attempted to sell off its domestic tobacco businesses. However, it was unable to close the deal with any of its potential buyers. When it became clear that selling off the tobacco businesses would be difficult, Liggett adopted an attitude of milking the business. Advertising expenditures were slashed and production was consolidated to allow closing of several factories. Largely because of these cutbacks, the cigarette business continued to make a profit (21). However, these steps also assured the continued decline of the cigarette business.

Liggett's history as an independent company ended in 1980 when it was acquired by Grand Metropolitan PLC, a large British Hotel and Liquor company. Grand Metropolitan was

manufacturer of J & B Scotch, which Liggett distributed in the U. S. through its Paddington subsidiary. Grand Metropolitan's acquisition of Liggett was an unfriendly takeover. During the struggle to keep from being acquired, Liggett sold off its Austin Nichols liquor subsidiary, to make itself less attractive to Grand Metropolitan. However, Liggett's distribution systems and product lines were still consistent with Grand Metropolitan's expansion goals in the United States, and the takeover was effected (57).

In 1980, Grand Metropolitan was the thirteenth largest company in Britain, with sales of 5.5 billion dollars per year. Liggett represented a good expansion base for its United States operations, especially in the liquor and food markets. However, cigarettes did not fit in with Grand Metropolitan's strategy. Under Grand Metropolitan, cigarette advertising continued to be cut back. In 1980, Liggett spent $503,800 to advertise its cigarette brands, compared to $7,079,700 in 1979, and $16,840,000 in 1978.

Liggett introduced generic cigarettes in 1980, and it was only through the success of this product that Liggett was able to enlarge its share of the cigarette business. Liggett was able to grow the business by obtaining several large contracts with distributors. Because of generics, Liggett and Myers Tobacco was able to reverse its market share

tailspin, showing market share gains in 1981 through 1985 (59)

However, cigarettes still did not fit in with Grand Metropolitan's long term plans. In 1983, Grand Metropolitan reorganized its Liggett Group subsidiary. The non-liquor operations were placed under a holding company called GrandMet USA, which represents Grand Metropolitan PLC's interests in the United States The liquor companies were placed under a separate operating division of Grand Metropolitan, International Distillers and Vintners. GrandMet USA absorbed the corporate staff of the Liggett Group in Montvale, New Jersey. Once this move was accomplished, GrandMet USA put its tobacco businesses up for sale. Liggett and Myers' management attempted to buy the business back from Grand Metropolitan in 1984, but the deal was not consummated. Liggett management was not able to obtain the required financing, due to the uncertain future of the Liggett cigarette lines.

In July 1985, GrandMet was able to sell the Pinkerton Tobacco subsidiary to a Swedish company, Svenska Tobaks AB. And finally, in November 1986 the Liggett Group was sold to investor Bennett S. LeBow. At the time of its sale, Liggett had approximately five percent of the domestic cigarette market, composed primarily of generics

BROWN AND WILLIAMSON

1954 - 1979

Brown and Williamson is a wholly owned subsidiary of British-American Tobacco (BAT). BAT is the major cigarette producer in the world, with over twenty percent of the world cigarette market.

Brown and Williamson was a steady performer throughout the 1950's, 60's and 70's. It too failed to respond quickly enough to the trends for filtered and low tar cigarettes, but it managed to capitalize on several successful brands such as Kool, to rise to number three (from number five) in industry market share. However, the rise to number three was not so much Brown and Williamson's doing. It resulted mainly from the poor performances by Liggett, American, and Lorillard. Brown and Williamson's unit sales actually fell from 103 billion in 1974 to 88 billion in 1979, while it was improving its market share.

Being a subsidiary of a diversified company made diversification a little more difficult for Brown and Williamson. Its strategy had to fit with BAT's strategy, and BAT resisted expansion through the Brown and Williamson unit, due to fear of the Securities and Exchange commission scrutiny of foreign investors. Finally, in 1969, Brown and

Williamson began diversifying by purchasing Vita Food Products, Aleutian King Crabs, and Sea Pass Corporation. This expansion into the food business was followed by the acquisitions in 1972 and 73 of Gimbel Brothers Department Stores, Sak's Fifth Avenue, and the Kohl Corporation (grocery chain). The moves into retailing were more consistent with BAT's corporate strategy (28).

Like the other cigarette companies, Brown and Williamson Tobacco changed its name, to Brown and Williamson Industries, in 1974. Later, BAT reorganized its American subsidiary operations as BATUS (for BAT, U.S.), and made Brown and Williamson a division within BATUS (58).

1979 -1987

Since its reorganization in 1979 as BATUS, Brown and Williamson's diversification pattern has followed the patterns of its parent company, BAT. BAT's strategy, as described by its chairman Patrick Sheehy, has been to diversify such that it is composed of four equal parts: tobacco, retailing, paper, and financial services (20, 51). Although BATUS has lagged behind its parent in the financial services area, it achieved a significant level of diversification through its acquisition and expansion of Appleton Papers Incorporated, and several grocery and

department store chains. In 1979, BATUS was composed of the following divisions:

Kohl's Food and Department Stores
Gimbel's Department Stores
Marshal Field Company
Appleton Papers

In the early 1980's, BATUS continued expansion of its retailing sector. By 1982, it had added Frederick and Nelson, J. B. Ivey, John Breuner Company, The Crescent, and Thimbles to the list above. The retail businesses in 1982 represented 2.97 billion dollars in sales compared to 2.13 billion for tobacco, but tobacco's operating income was 364.4 million dollars compared to retailing's 161.8 million. BATUS' retailing sector was the 19th largest retailing business in the United States.

The papermaking side of BATUS has been a relatively minor portion of the company compared to retailing and tobacco. In 1983, Appleton's operating income was 80 million dollars, on sales of 465 million dollars. However, the paper business still played a role in BATUS' strategy. In 1984, BATUS sought to strengthen its presence in this segment with the purchases of two paper mills, one from the P. H. Glatfelter Company and the other form the Nashua Company.

BATUS' aggressive moves into the retailing business have not been totally successful. The Gimbels chain had difficulties

turning consistent profits since its purchase, and the other retailing units began to show signs of faltering in the 1980's. In 1986, BATUS undertook a major restructuring of its retailing operations, selling off or closing its Gimbels stores, and selling the Kohl's, Frederick and Nelson, and The Crescent chains. The businesses sold represented 1.4 billion dollars in sales. BATUS kept Sak's, Marshal Fields, Ivey's, Breuners, and Thimbles in its retailing sector, for a combined presence in retailing of 2.4 billion dollars per year in retail sales.

BATUS remained a strong force in the cigarette market, with the introduction of one of the most successful new brands in the 80's, Barclay. This cigarette had a controversial new filter which allowed Brown and Williamson to claim that the cigarette a 99 percent tar reduction. Based largely on the success of this brand, and its move into the generic market, Brown and Williamson has been able to hold on to third place in the domestic cigarette market. Brown and Williamson also has a healthy export business, with successes in Japan and other countries in the Far East.

CHAPTER IV

DIVERSIFICATION STRATEGIES AND RESULTS, 1979-1986

Background

As we saw in the previous chapter, the evolution of the Big Six has resulted in major changes in their structures, both within and outside the tobacco industry. Within the industry, we have seen a concentration on cigarettes. None of the Big Six are currently involved in any tobacco products other than cigarettes whereas in 1979 American had a significant presence in cigars, and R. J. Reynolds and Lorillard had other tobacco products such as chewing and pipe tobaccos. We also saw the emergence of generic cigarettes, which helped Liggett survive in the business, but created a price competition within the cigarette market which has affected the way cigarettes are marketed.

Our focus in this paper is to look at non-tobacco activities of the Big-Six, and in this area the changes have been astronomical. Since 1979, diversification activities have resulted in major changes in the structures and the financial performance of the Big Six. Liggett, as we saw earlier, has made a full circle- from tobacco company, to diversified conglomerate, to diversified subsidiary, and now back to a cigarette company looking for diversification opportunities.

R. J. Reynolds and Philip Morris have become major forces in the food industry, and have withdrawn from other business lines. And Lorillard, after carrying the Loews corporation through some difficult times in the early 80's has now resumed its role as the cash cow for Loews' continued diversification activities.

Methodology

I analyzed the relative success of the Big Six in non-tobacco businesses in financial terms. The focus was to look at the profit contributions of the non-tobacco businesses of the Big Six, and the returns on investments provided by the non-tobacco businesses The primary sources of data were corporate annual reports, financial periodicals, and investment company reports.

In conducting the analysis, I determined that data for Liggett and Brown and Williamson would not be directly comparable to the other four. Both of these companies were subsidiaries of foreign corporations during the period of interest, and specific financial information on their operations was not available. In addition, their non-tobacco operations were driven by the overall corporate strategies of their parent companies, so that Liggett and Brown and Williamson were not in direct control of their diversification strategies. This is quite evident in the

case of the Liggett Group, which was acquired by Grand Metropolitan, stripped of all its non-tobacco operations, and then spun off as a cigarette company again. For these reasons, Liggett and Brown and Williamson were not included in the analysis.

Although Lorillard was also not a surviving corporate entity, it was retained in the analysis because Lorillard was a major factor in the diversification strategies of the Loews Corporation. It supplied a large portion of Loews' cash flow during the early 1980's. Lorillard (Loews Corporation) also provides us with a good contrast in diversification strategies with the other three companies retained in the study.

Measures of Success

Two criteria were set for comparisons of the four companies: degree of diversification, and financial performance of non-tobacco businesses. Within these overall criteria, several analyses were conducted to arrive at quantitative measures of success. For the tobacco companies, degree of diversification is a significant measure because of the volatility of the industry in current times. The industry enjoys very favorable profit margins and cash flows, yet tends to have undervalued stock because of perceived problems with regard to product liability lawsuits and the overall

decline in the domestic cigarette market. Through diversification, the industry can ease some of these fears on the part of current and potential stockholders. The relative financial performance of the non-tobacco businesses is the other critical factor in comparing the companies' strategies, because the companies must invest the tobacco profits wisely in order to insure the high returns that tobacco company stockholders expect.

Analysis of Acquisitions/Divestitures

In the May-June 1987 issue of the Harvard Business Review, Michael Porter analyzed the diversification trends of major U.S. corporations (55). However, instead of detailed financial analysis, he used one semi-quantitative measure: the number of acquisitions versus the number of divestitures for each company. His logic is based on the simple assumption that companies don't divest successful operations, except in very rare changes of strategy. Using this simple technique, Dr. Porter was able to make some observations on the corporate strategies of American corporations, which were not very complimentary:

> The track record of corporate strategies has been dismal. I studied the diversification records of 33 large, prestigious U.S. companies over the 1950-1986 period and found that most of them had divested many more acquisitions than they had kept. The corporate strategies of most companies have dissipated instead of created stockholder wealth (55).

The Big Six were not included in Dr. Porter's study, although General Foods, which was acquired by Philip Morris, was one of his original group of companies.

Dr. Porter found that the divestment rate for acquisitions in non-related fields was 74 percent, a key result in backing up his conclusions on the poor performance of corporate strategies.

In order to assess the tobacco companies' acquisition record, ⁻ summarized their acquisition/divestiture histories from 1979-1987 The results are shown in Tables IV-VII. These results can not be compared directly to Porter's observations for the companies he studied, because it covers a much shorter time frame than Porter's analysis However, by analyzing the information available for the cigarette companies we can see not only their recent acquisition/divestiture track records but also the different strategies applied by the companies. For example, Table IV provides a clear indication of Loews' approach, wn ch is a portfolio management strategy.

oews' acquisitions came through purchases of blocks of uities of the target companies Loews had a relatively ll number of shareholders (approximately 7,000), and more n fortv percent of the ownership was shared by the Tisch others. The Loews Corporation has been handled essentially

as an investment portfolio, with Lorillard supplying the infusion of cash needed for acquisitions. In addition to the operating companies, the corporation had a sizeable equity portfolio (1.2 billion dollars in 1986). At one point Loews owned 5.4 percent of the American Broadcasting Company and 5.22 percent of General Foods. CNA, which is now the major subsidiary in the Loews family, was acquired piecemeal over a ten year period. The CNA subsidiary gave the Tisch brothers another conduit through which to make investment moves. Many of the investments made in the 1980's were made jointly by the parent corporation and the insurance subsidiary, although the investment incomes for the parent and subsidiary were reported separately.

In 1985, Loews began to purchase shares of CBS stock, and built up its ownership of CBS to 25 percent in 1987. Lawrence Tisch became chairman of CBS, and it appeared that the two companies were headed for a merger. Loews' strategy for acquiring CNA and CBS is in sharp contrast with the strategies of Reynolds and Philip Morris. Loews preferred to acquire equity in the acquired companies over a long period of time, whereas Philip Morris and Reynolds made major acquisitions all at once.

Table IV shows that Loews became more diversified in the period 1979-1987. It added the Bulova company to its business lines, consolidated its investment in the insurance business

through increased ownership of CNA, and began its purchase of CBS. In addition, Loews entered the shipping business by purchasing several tankers and forming the Majestic Shipping Company. However, Loews also made some key divestment moves when it sold the General Finance subsidiary, and its original business, Loews Theatres.

In contrast with Loews, Reynolds has moved to consolidate, rather than diversify its business lines. As Table V shows, Reynolds sold its energy, transportation, and distilled spirits businesses, and made significant purchases in the food business. The dollar amounts of Reynolds' acquisitions and divestitures are key indicators of Reynolds' major shift in strategy. Reynolds divested of 4.4 billion dollars of previous acquisitions in the period 1979-1986, and spent 7.2 billion dollars in new acquisitions. This is by far the largest ratio of divestments to acquisitions for the four companies analyzed.

Table VI shows the dynamic acquisition strategy of American Brands. American had established its strategy for business lines by 1979, and in the period 1979-1987 it concentrated on building up these lines through acquisitions of small companies to supplement its existing businesses. Although American has grown considerably during the period and has increased the size of its non-tobacco portfolio, it has actually become a less diversified corporation in terms of

the number of unrelated businesses. At the same time that it has been adding to its office products, financial services, and distilled spirits businesses, American has been divesting its food businesses, such as Duffy-Mott, Taylor Foods, and Sunshine Biscuits. (The plan to divest Sunshine Biscuits was announced in December 1987.) The Sunshine Biscuits divestiture is significant because this was the first acquisition in American's diversification program, in 1966.

Philip Morris, shown on Table VII, was the only one to make a significant acquisition in the tobacco business. It had purchased Liggetts' international brands in 1978, and in 1981 it purchased a 20 percent share of the holdings of Rothmans International. As the table shows, Philip Morris also decreased its number of business lines in 1979-87. It sold off the companies in its Industrial group, and also sold the Seven-Up company. These actions, in conjunction with the purchase of General Foods, have made Philip Morris less dependent on tobacco, yet more concentrated in the area of consumer products.

The acquisition/divestiture tables show the wide differences in the companies' strategies, but they also reflect the underlying differences in the success of the companies within and outside the tobacco industry. Philip Morris' success in the cigarette industry is highlighted by the fact that in one single purchase (General Foods) it spent more than twice the

amount that American spent for acquisitions from 1979 to 1986. American's success outside the tobacco industry is shown by its ratio of divestitures to acquisitions, which is the lowest of the four companies And, Reynolds complete rearrangement of its business lines is indicative of its struggle to develop a corporate identity and preserve its profit margins. During the time period covered by this study, Reynolds lost its number one market share position in the cigarette industry to Philip Morris. Its major cigarette brands lost both volume and market share. At the same time, its energy and shipping subsidiaries were faced with difficult times due to the volatility of oil prices.

TABLE IV

LOEWS CORPORATION ACQUISITIONS AND DIVESTITURES

1979-1987

YEAR	ACQUISITION	AMOUNT*	DIVESTITURE	AMOUNT
1979	Bulova Watch Co.	35		
	Increased ownership of CNA from 58 to 79 %.	166		
1981	5.4 % of American Broadcasting Co.	44		
1981			Drake Hotel, N. Y.	74
1981	5.22 % of General Foods	81		
1981			350,000 Shares of General Foods (Reduced ownership to 4.8 %)	11
1983			Wheeling-Pittsburgh Co. (lowered ownership from 17 % to 2.5 %	13
			General Finance Corp.	193
1984	4.8 % of Storer Communications	24		
[illegible]4	8.5 % of St. Regis Corporation	100		
[illegible]5-[illegible]	Purchased shares of CBS Inc., to 25 % ownership.	1,061		
	Formed Majestic Shipping Co.	47		
			Loews Theatres Group	158
	Total:	1,558		449

Amounts in millions of dollars.

TABLE V

R. J. REYNOLDS ACQUISITIONS AND DIVESTITURES

1979-1987

...ISITION	AMOUNT[1]	DIVESTITURE	AMOUNT
...nte Co.	618		
		Cut & Ready Potatoes	N/A[2]
		Endico Potatoes	N/A
		Granny Goose Snacks	N/A
		California Pretzel	N/A
... Frozen Foods	N/A	Alaska Packers Assoc.	N/A
...ch AG	N/A		
... Management & Services	N/A		
...n Inc.	1,295		
...reek Corp.	74		
...oc Inc.[3]	40		
... Soft Drinks	57	Sea-Land Corp.[4]	400
... Dry	175	Aminoil Inc.	1,700
... Brands	4,900	Service Systems Corp.	N/A
		Skolniks Bagel Bakeries	N/A
		Dental Care of America	
		Kentucky Fried Chicken	840
		Canada Dry and Sunkist	230
		Chuckles Candies	N/A
		Bear Creek Corp.	N/A
		Filmco Internatioanl	35
		Heublein Inc.	1,200
...te Total:	7,159		4,405

... millions of dollars.

... disclosed. Items shown as N/A are considered minor ... divestitures, and do not significantly affect the

... started as a joint venture between R. J. Reynolds and

... spun off to R. J. Reynolds stockholders. R. J. Reynolds ... 400 million dollars by the new Sea-Land Company.

TABLE VI

AMERICAN BRANDS ACQUISITIONS AND DIVESTITURES

1979-1987

YEAR	ACQUISITION	AMOUNT[1]	DIVESTITURE	AMOUNT
1979	Completed the acquisition of Franklin Life Insurance Co.	644		
1981	Offrex Group Limited (Great Britain)	70		
	Miscellaneous purchases by Gallaher subsidiary	34		
1982			Duffy-Mott	60
1983	Pinkerton's Security	159		
	Eastlight Limited (Great Britain)	36		
1984	Southland Life Insurance	355		
	Prestige Group LTD. (Great Britain)	72		
1985	Foot-Joy Inc.	54		
	Dexter Lock Co.	N/A[2]		
	Bonny Products Inc.	N/A		
1986	BASIX Controls	28	American Cigar	14
	NSS Newsagents PLC (Great Britain)	126		
1987	ACCO World Inc.	600	Taylor Foods	18
	National Distillers and Chemical	545		
	Approximate Total:	2,723		92

[1] Amounts in millions of dollars.
[2] Amounts were not disclosed. Items shown as N/A are considered minor acquisitions, and do not significantly affect the totals.

TABLE VII

PHILIP MORRIS ACQUISITIONS AND DIVESTITURES

1979-1987

[illegible]SITION	AMOUNT[1]	DIVESTITURE	AMOUNT
[illegible] Rothmans [illegible]national	350		
		Nicolet Paper	N/A[2]
		Wisconsin Tissue Mills, and Plainwell Paper	210
[illegible] Foods	5,600		
[illegible]ffee Co.	N/A	Seven Up International	246
[illegible] Britain)	N/A	Seven Up Domestic	240
[illegible] Foods [illegible])	N/A		
[illegible]ide Snacks [illegible])	N/A		
[illegible] Freihofer [illegible]ing	100		
[illegible]imate Total:	6,050		696

[illegible] millions of dollars.
[illegible] not disclosed. Items shown as N/A are considered minor [illegible]divestitures, and do not significantly affect the

Degree of Diversification

Economists have developed an index for market concentration, called the Herfindahl-Hirschman Index, (or H-Index) (2, 8). The normal use for this index is to measure the degree of concentration in a given industry, for example, to determine if an anti-competitive situation exists in that industry. Berry utilized a modified version of this index to determine the degree of diversification of a given firm in several business lines (13). The index, as modified by Berry, is:

$$H = 1 - \Sigma p_i^2$$

where p represents the fraction of revenue (or income) that the firm receives from a particular business line. For example, in 1986 Philip Morris received 12 percent of its revenue from beer, 38 percent from food, and 50 percent from tobacco. Therefore its diversification index is $H = 1 - (.12^2 + .38^2 + .50^2) = .59$. An H-Index of 0.0 represents a totally undiversified firm. The higher the H-Index, the more highly diversified the firm is.

The diversification indices for the four companies in this study were computed, for both revenue and operating income. The results are shown in Table VIII.

TABLE VIII

DIVERSIFICATION INDICES FOR THE INDEPENDENT CIGARETTE COMPANIES

REVENUES

YEAR	PM	RJR	LTR	AMB
1979	0.51	0.56	0.74	0.60
1980	0.50	0.63	0.74	0.58
1981	0.50	0.65	0.73	0.57
1982	0.48	0.66	0.71	0.56
1983	0.45	0.58	0.72	0.59
1984	0.44	0.51	0.70	0.61
1985	0.51	0.50	0.66	0.61
1986	0.59	0.46	0.61	0.60

OPERATING INCOME

YEAR	PM	RJR	LTR	AMB
1979	0.32	0.35	0.83	0.53
1980	0.25	0.37	0.77	0.52
1981	0.20	0.43	0.76	0.65
1982	0.18	0.44	0.52	0.61
1983	0.23	0.43	0.56	0.63
1984	0.14	0.30	0.50	0.64
1985	0.19	0.40	0.69	0.62
1986	0.40	0.46	0.66	0.60

Legend:

PM = Philip Morris　　RJR = R. J. Reynolds

LTR = Loews Corporation　　AMB = American Brands

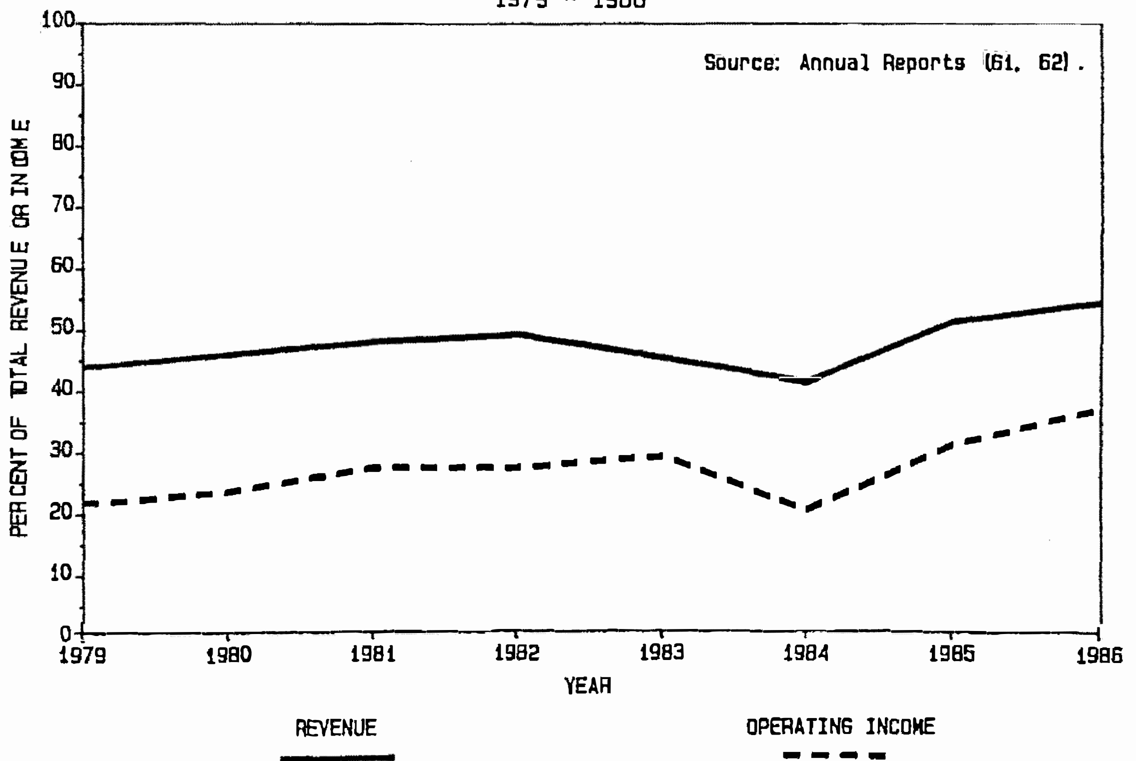
Table VIII shows clearly the concentration of Philip Morris' operating income throughout the early 1980's. Although Philip Morris had made acquisitions in the beer and soft-drink industries, and although Miller had made significant progress in sales volume and market position, the overwhelming portion of operating income still came from cigarettes. Figure IV shows that from 1978 to 1982 the non-tobacco contribution to operating income actually decreased. It wasn't until 1986, with the acquisition of General Foods, that non-tobacco income increased significantly. However, even in 1986, the first full year of General Foods figures, operating income from non-tobacco operations was 20 percent of the total, compared with 50 percent of the revenues.

R. J. Reynolds diversification index shows it to be more diversified throughout the early eighties than Philip Morris. It was during this period that Reynolds was involved in the energy and transportation businesses, in addition to the food and tobacco businesses. RJR's revenue concentration index shows it becoming less diversified, as it began to spin off businesses to concentrate on tobacco and foods. However, as Figure III shows RJR's tobacco vs. non-tobacco income contribution is similar to Philip Morris. Non tobacco businesses in 1986 accounted for over 60 percent of the revenue, but only 30 percent of the operating income.

Loews' diversification index shows it to be the most diversified corporation of the four, in both revenue and income However the indices for 1982-1985, and the tobacco vs. non tobacco income for these years (Figure VI) show a very dramatic picture of the importance of Loews' Lorillard tobacco unit. During these years, Loews' insurance and financial services went through some difficult periods created by the competitive situation in the life insurance business. Had it not been for the income generated by the Lorillard unit, Loews would have reported some very dismal income figures for those years. Figure VI shows that in 1982-84 non-tobacco income dropped to approximately 35 percent of corporate income, compared to 77 percent in 1979.

American's indices show it to be the most stable in terms of both revenue and income As stated earlier, American had settled on a business-line strategy prior to 1979, and concentrated on building up those lines through acquisitions. Figure V shows a very close match between tobacco and non-tobacco revenues and income. However, this result is somewhat misleading because, as we shall see later, American's profit margin on tobacco was much lower than the others. The majority of American's tobacco revenue came from its international unit, and the profit margins on the international sales were considerably lower than on domestic sales.

FIGURE 3
R. J. REYNOLDS NON-TOBACCO REVENUE AND INCOME
1979 - 1986



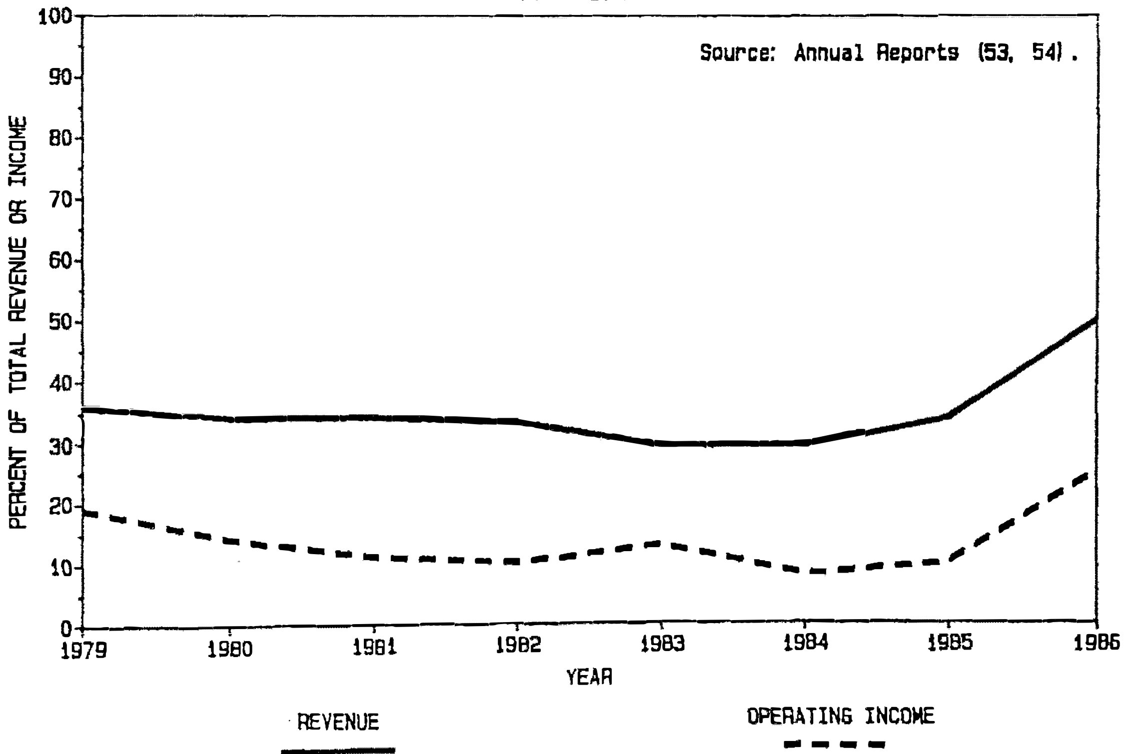


FIGURE 4
PHILIP MORRIS NON-TOBACCO REVENUE AND INCOME
1979 - 1986
Source: Annual Reports (53, 54).
PERCENT OF TOTAL REVENUE OR INCOME
100
90
80
70
60
50
40
30
20
10
0
1979
1980
1981
1982
1983
1984
1985
1986
YEAR
REVENUE
OPERATING INCOME

FIGURE 5
AMERICAN BRANDS NON-TOBACCO REVENUE AND INCOME
1979 - 1986

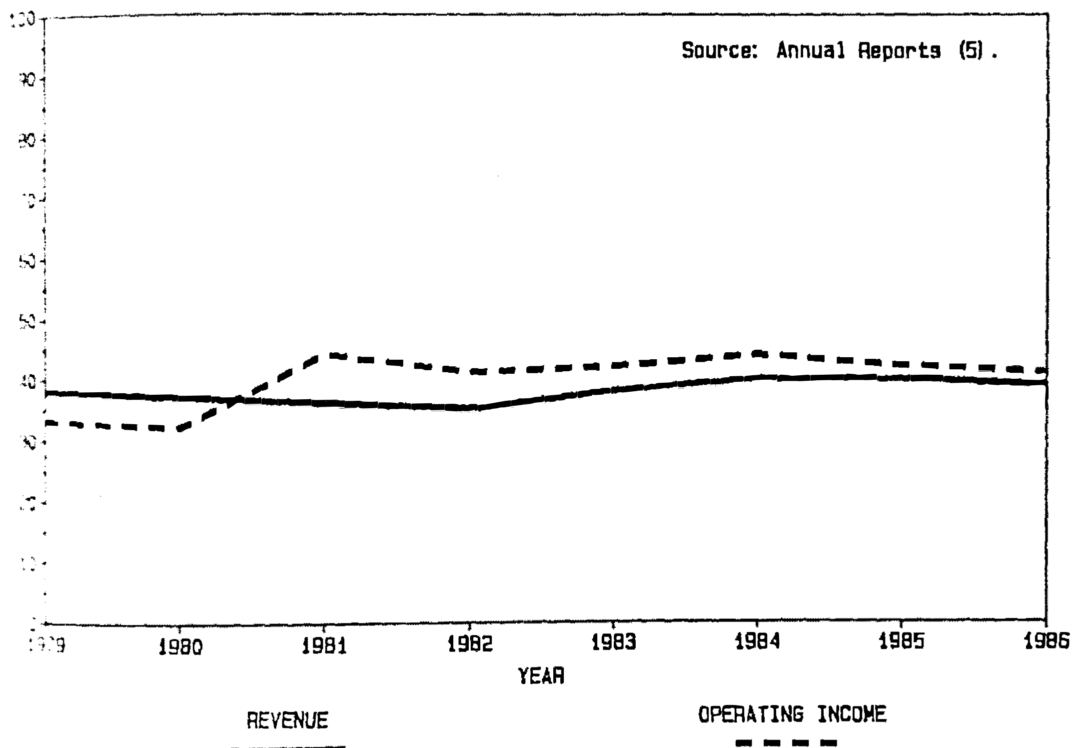
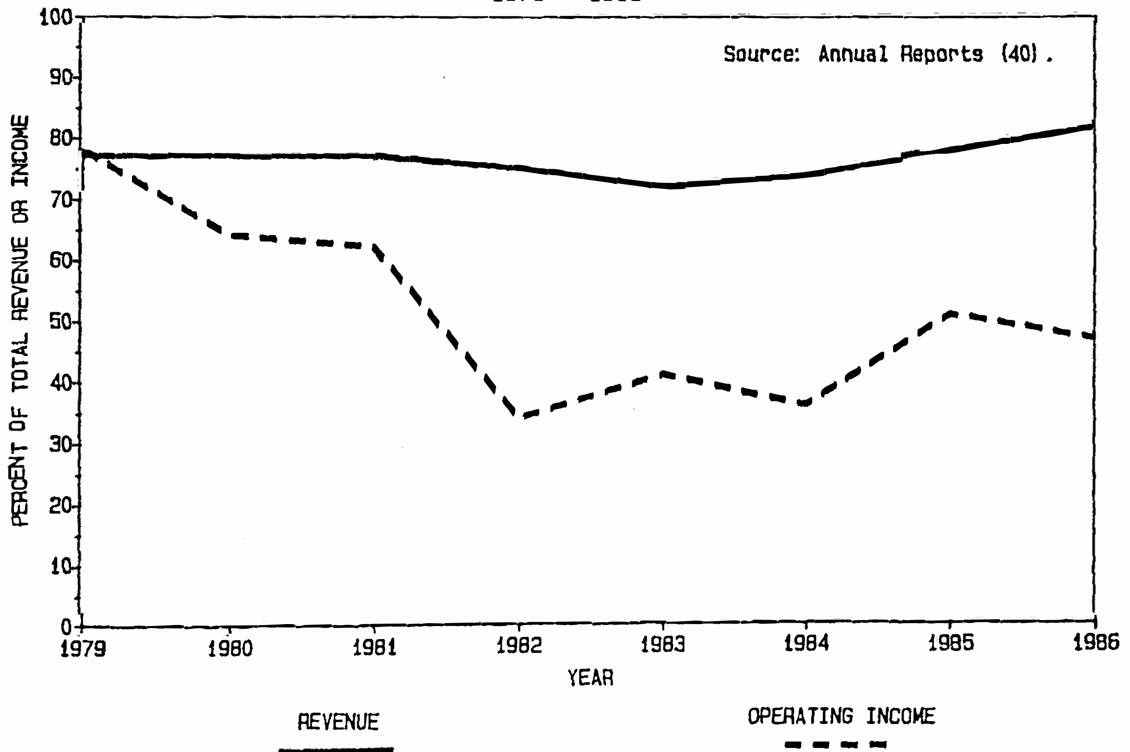


FIGURE 6
LOEWS CORPORATION NON-TOBACCO REVENUE AND INCOME
1979 - 1986



Profitability of Non-Tobacco Operations

The most important measure of success is the profit margin contribution that the non-tobacco businesses have made to the corporation. Tobacco versus non-tobacco margins (operating income before taxes and interest, divided by revenue) are shown in Table IX. This table shows that only American has been able to achieve profit margins in the non-tobacco sector that approach those of the tobacco sector. And, this result is skewed by the low profit margins of American's international tobacco operations. American's domestic tobacco margins are in the 26-29 percent range, compared to the international tobacco margins of 4 percent.

However, the key piece of information provided in table IX is the profit margins of the non-tobacco businesses, and in this area American is the clear leader. Its non-tobacco profit margins have ranged from 11 to 15 percent over the last five years. Philip Morris had only one year above five percent, and Loews had several of five percent or less, during its problems in the insurance business.

Results such as those shown in Table IX led Seneker to declare American the "winner" in the diversification game (67). In a Forbes article published in August 1985, Seneker compared American's diversification results to those of the other cigarette companies, and concluded that American has

.. best use of its tobacco money to diversify into non-
areas.

on Assets

way to measure the performance of the non-tobacco es is to analyze their returns on non-tobacco and assets. In order to make direct comparisons, I return on assets (ROA) by dividing operating profits acco and non-tobacco segments by their respective lues. Therefore these ROA's are on a pre interest, basis Table X shows the results.

omparisons can be made from Table X. First, we can relative differences between tobacco and non-tobacco each company. We can also compare the performance of bacco and non tobacco segments among the four es.

g at the tobacco segments for each company, we see rican's ROA's have held relatively steady. American olidated its tobacco operations and has not made any pital expansions, because of its decreasing market

shown dramatic increases in its tobacco ROA. During 1980's Loews' Lorillard division consolidated its

production facilities into one major manufacturing facility in North Carolina. Lorillard's results are also helped by the fact that it has no international tobacco operations.

Philip Morris and RJR are the only companies which have made major investments in the tobacco area in the last ten years. Philip Morris has made major capital investments in the United States and overseas, and these results are evident in its increasing ROA over the last eight years. Reynolds undertook a multi-year one billion dollar capital investment in its domestic cigarette operations in 1981. The results of that program have been to reduce ROA. However, once the program is completed in 1988, Reynolds will reap the benefits of reduced manufacturing costs.

In the non-tobacco areas, the results again point to American Brands as the leader. From 1979 to 1986 American achieved ROA's which were twice as high as those of the other three.

TABLE IX

TOBACCO AND NON-TOBACCO OPERATING MARGINS

FOR THE INDEPENDENT TOBACCO COMPANIES

YEAR:	79	80	81	82	83	84	85	86
PHILIP MORRIS:								
DOMESTIC TOB.	0.25	0.24	0.24	0.25	0.24	0.28	0.31	0.34
INT'L TOB.	0.10	0.10	0.11	0.13	0.10	0.11	0.11	0.09
TOTAL TOB.	0.18	0.17	0.18	0.20	0.19	0.22	0.23	0.23
NON-TOB.	0.08	0.06	0.04	0.05	0.07	0.05	0.05	0.05
R. J. REYNOLDS:								
DOMESTIC TOB.	0.23	0.23	0.23	*	*	*	*	0.31
INT'L TOB.	0.08	0.08	0.08					0.18
TOTAL TOB.	0.17	0.17	0.18	0.17	0.15	0.17	0.18	0.28
NON-TOB.	0.06	0.06	0.07	0.07	0.07	0.06	0.08	0.09
LOEWS CORPORATION:								
TOBACCO.	0.12	0.15	0.16	0.20	0.17	0.20	0.22	0.28
NON-TOBACCO	0.12	0.08	0.08	0.03	0.05	0.04	0.07	0.05
AMERICAN BRANDS:								
DOMESTIC TOB.	0.24	0.25	0.26	0.28	0.26	0.27	0.29	0.25
INT'L TOB.	0.04	0.05	0.05	0.04	0.04	0.04	0.04	0.04
TOTAL TOB.	0.11	0.10	0.10	0.11	0.11	0.12	0.12	0.10
NON-TOBACCO	0.08	0.08	0.15	0.14	0.13	0.14	0.13	0.11

* Reynolds did not break domestic vs. international figures for these years.

Note: Loews does not have an international tobacco business.

TABLE X

TOBACCO AND NON-TOBACCO RETURN ON ASSETS

FOR THE INDEPENDENT TOBACCO COMPANIES

YEAR:	79	80	81	82	83	84	85	86
PHILIP MORRIS:								
TOBACCO	0.29	0.28	0.26	0.31	0.33	0.42	0.44	0.49
NON-TOBACCO	0.08	0.06	0.04	0.05	0.08	0.06	0.03	0.09
TOTAL	0.20	0.19	0.17	0.20	0.24	0.29	0.17	0.24
R. J. REYNOLDS:								
TOBACCO	0.42	0.44	0.40	0.37	0.35	0.36	0.33	0.34
NON-TOBACCO	0.05	0.06	0.08	0.06	0.07	0.06	0.05	0.07
TOTAL	0.17	0.17	0.19	0.15	0.16	0.17	0.13	0.15
LOEWS CORPORATION:								
TOBACCO	0.19	0.28	0.31	0.41	0.45	0.48	0.60	0.77
NON-TOBACCO	0.05	0.03	0.03	0.01	0.02	0.01	0.02	0.02
TOTAL	0.06	0.05	0.05	0.03	0.04	0.03	0.04	0.07
AMERICAN BRANDS:								
TOBACCO	0.26	0.26	0.26	0.28	0.30	0.34	0.32	0.29
NON-TOBACCO	0.13	0.13	0.12	0.12	0.13	0.12	0.10	0.07
TOTAL	0.19	0.20	0.19	0.20	0.21	0.22	0.19	0.17

Capital Investments

In addition to acquisitions outside tobacco, the four tobacco companies have been making significant capital investments in these businesses to increase their markets and improve manufacturing efficiencies. Again, it is interesting to note the degree of investments in support of the tobacco and non-tobacco segments for each company. This analysis was conducted by computing the ratio of capital expenditures to existing assets for each company. The results are shown on Table XI.

Loews' non-tobacco results cannot be compared directly to the other three because of Loews heavy involvement in industries such as financial services, which do not require large capital expenditures. However, comparing the others we can see that both Philip Morris and Reynolds made heavy capital expansions in the non-tobacco businesses during the early 1980's. During this time, Philip Morris was still increasing Miller's brewing capacity, and Reynolds was investing heavily in its energy, transportation, and food businesses. The numbers are indicative of the changes that these two companies have under gone in the last five years. In Reynolds' case, the results for the last five years reflect its divestitures of the energy and transportation businesses, and its decision to invest in the acquisitions of food and beverage businesses such as Nabisco and Heublein, instead of

investing more in the existing subsidiaries. Philip Morris completed its major expansions in the brewing area, and also turned its attention to non-tobacco acquisitions. The results for 1985 show Philip Morris investing only 1.5 percent of its non tobacco assets. This number is artificially low due to the impact of the General Foods acquisition late in the year, which practically doubled the year-end asset base.

American Brands' pattern of capital expenditures did not change significantly. American continued its strategy of supporting its business lines, while making acquisitions in areas related to the business lines it had established before 1979.

The tobacco investment numbers are also of interest, because they reflect the diversification strategies of the companies. In this regard we can see that both Philip Morris and Reynolds have made significant additions to their tobacco asset bases, whereas the other two have not. Table XI reflects the major construction programs conducted by Philip Morris in the early 1980's, which included the completion of one new factory in North Carolina, and a major investment in its existing Louisville operation, as well as significant international investments. Reynolds' results reflect the major investment Reynolds began in 1981 to build its

Tobaccoville facility in North Carolina, in addition to major improvements to its existing facilities.

The tobacco investment results also reflect the status of the companies tobacco businesses. Philip Morris has continued to invest in tobacco because its performance in the business warranted a growth oriented capital investment program. Reynolds major investments in tobacco reflect an attempt to improve manufacturing efficiencies, and support its fight with Philip Morris to regain market shares. American and Loews have continued their strategy of supporting but not expanding their tobacco businesses.

TABLE XI

CAPITAL EXPENDITURES

FOR THE FOUR INDEPENDENT TOBACCO COMPANIES

(Expressed as percent of existing capital assets

in tobacco or non-tobacco business lines)

YEAR:	79	80	81	82	83	84	85	86
PHILIP MORRIS:								
TOBACCO	5.9	9.6	11.5	9.8	6.3	3.2	2.7	3.3
NON-TOBACCO	14.2	9.8	8.7	7.9	5.6	3.2	1.5	4.6
TOTAL	9.6	9.7	10.3	9.0	6.0	3.2	1.9	4.1
R. J. REYNOLDS:								
TOBACCO	3.8	5.4	6.1	7.3	11.4	14.1	14.4	12.6
NON-TOBACCO	13.9	14.8	11.3	8.3	8.4	5.3	4.4	3.6
TOTAL	10.7	12.0	9.5	8.0	9.4	8.9	7.1	6.2
LOEWS CORPORATION:								
TOBACCO	2.6	2.6	3.9	2.1	2.4	3.5	3.2	2.8
NON-TOBACCO	0.4	0.4	0.7	0.7	0.5	0.5	0.4	0.4
TOTAL	0.6	0.6	0.9	0.8	0.6	0.6	0.5	0.5
AMERICAN BRANDS:								
TOBACCO	3.3	5.5	4.7	4.2	3.7	4.3	3.8	5.1
NON-TOBACCO	5.1	6.2	4.9	5.0	4.3	5.4	.5.1	7.1
TOTAL	4.2	5.8	4.8	4.6	4.0	5.0	4.5	6.3

CHAPTER 5

CONCLUSIONS

The Effects of Diversification

In the years 1979-1987 the tobacco companies have decreased their dependence on tobacco through investments in unrelated businesses. However, tobacco is still the major contributor to operating income, as shown below:

COMPANY	PERCENT OF OPERATING INCOME PROVIDED BY TOBACCO (1986):
Philip Morris	75
RJR-Nabisco	63
American Brands	59
Loews	53

By analyzing the companies' acquisitions and divestitures we observed that Philip Morris, RJR-Nabisco, and American are more diversified today than they were in 1979, as measured by their Herfindahl concentration indices. However, these three companies are represented in less industries today than they were in 1979. This result is due to corrections in their diversification strategies, away from the "diversified conglomerate" approach to a more conservative strategy which builds upon their marketing strengths.

Loews, on the other hand, had to rely heavily on tobacco income in the early 1980's. But, having passed through the difficulties in its financial services businesses, Loews resumed its diversification through portfolio management strategies. It divested its original theater business, made heavy investments in CBS and other unrelated businesses.

Only Philip Morris and RJR-Nabisco made significant investments in the tobacco business. These two market leaders are poised for a continuing head-to-head battle in the years ahead. The other companies are continuing to support their cigarette operations, but only to the extent that they generate cash for continued growth in unrelated areas.

In comparing the relative successes of the tobacco companies outside the tobacco businesses, the advantage must be given to American Brands. Its non-tobacco businesses have the highest profit margins and ROA's of the four companies analyzed. After its initial loss of superiority in the cigarette industry, American set upon a diversification strategy which allowed it to grow in spite of its losses in cigarette volume and market share. Its strategy of making small acquisitions to add to its business lines has worked well, and will probably continue in the future. American, like Philip Morris and RJR-Nabisco, made some mid-course

corrections, when it got rid of some businesses to concentrate in its areas of strength.

Diversification as a Corporate Strategy

Although most of the literature on the industry tends to focus on diversification as a result of the smoking and health controversy, the tobacco companies have gone through an evolution in the last decade which is very similar to that of many other diversified corporations. During these years of corporate raiders and accelerated merger and acquisition activity, external forces have caused the cigarette companies to re-evaluate their diversification strategies, resulting in major changes in direction. They experienced the difficulties of managing the growth and synergy of unrelated subsidiaries, and modified their strategies based on this experience.

The analyses of financial performance inside and outside the industry, reported in the previous chapter, point to the single largest challenge that the industry has faced in terms of diversification decisions- the identification and acquisition of businesses with profit margins approaching those produced by tobacco. The results show that none of the businesses acquired by the companies studied have produced profit margins approaching those of the core cigarette business. Therefore, as the companies have pursued

diversification strategies, they have left themselves open to the question of whether their stockholders have truly benefitted from these strategies.

One of the premises, or "facts of life about diversification" stated by Porter is:

> Shareholders can diversify their own portfolios of stocks by selecting those that best match their preferences and risk profiles. Shareholders can often diversify more cheaply than a corporation because they can buy shares at the market price and avoid hefty premiums (55).

According to Porter, "...corporate strategy cannot succeed unless it truly adds value- to the business units by providing tangible benefits that offset the inherent costs of lost independence and to shareholders by diversifying in a way that they could not replicate (55)."

The question of whether tobacco company stockholders are better off as a result of diversification strategies can only be approached in a hypothetical sense- any attempt at quantification would quickly lead to a set of "what if" scenarios, comparing results achieved by the diversified company with what the parent and subsidiary could have achieved independently. This type of analysis would have been difficult, if not impossible to conduct. However, by comparing the financial performance of the cigarette companies to each other over the same time period we were

able to observe their relative successes outside the industry. This non-tobacco performance is an indication of the value that the acquired businesses have added to the corporations.

The cigarette companies' strategies have been affected by factors specific to their industry, and by the radical changes in the financial markets of the 1980's. Their future successes and failures will be based upon how they formulate and implement strategies to compete in their traditional business while enlarging their participation in other businesses. As this story continues to unfold, we can look for continued patterns of acquisitions by American, RJR-Nabisco and Philip Morris, while Loews continues its gradual absorption of CBS, and it portfolio management strategy. It will also be interesting to observe the re-emergence of Liggett as a public corporation, and at its renewed attempts at diversification.

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APPENDIX

Financial data from corporate annual reports.

(All dollar figures are stated in millions of dollars)

AMERICAN BRANDS TOBACCO AND NON-TOBACCO REVENUES AND INCOME

DATA FROM ANNUAL REPORTS:

	1979		1980		1981		1982		1983		1984		1985		1986	
	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME
FINANCIAL SERVICES						134		130		132		173		174		176
HARDWARE	224	46	229	43	240	46	174	27	462	44	519	48	569	43	679	43
FOOD PRODUCTS	490	26	536	28	561	35	470	32	479	33	494	29	507	27	533	28
DIST. BEVERAGES	171	24	189	27	211	31	227	33	241	37	246	39	250	40	255	35
OFFICE SUPPLIES	154	27	162	29	189	29	313	25	319	31	336	34	337	17	347	(12)
OPTICAL GOODS	86	16	106	21	102	18	117	19	144	32	130	18	143	18	172	15
GOLF PRODUCTS	60	8	69	10	81	12	93	14	113	17	123	20	167	22	224	30
RETAILING	375	3	496	8	505	12										
TOILETRIES	89	7	98	8	120	10	120	7	126	7	133	8	147	9	154	11
RUBBER PRODUCTS	50	6	43	6	51	7										
WHOLESALING	350	2	345	3	103	3										
ENGINEERING	143	13	184	14	143	1										
MISCELLANEOUS	62	7	64	8	73	9	795	31	792	25	785	26	799	27	937	23
LESS: INTERCO. SALES	(20)		(19)		(22)											
TOBACCO, TOTAL	3,614	386	4,299	439	4,183	438	4,196	464	4,417	494	4,229	497	4,390	520	5,169	499
DOMESTIC TOBACCO	1,150	281	1,182	293	1,178	302	1,223	344	1,445	371	1,411	382	1,429	408	1,414	351
INT'L TOBACCO	2,464	105	3,116	147	3,005	136	2,973	120	2,972	123	2,818	114	2,961	111	3,756	147
TOTAL	5,846	572	6,802	643	6,538	784	6,505	782	7,093	851	6,995	892	7,308	898	8,470	847
TOBACCO, %	62%	68%	63%	68%	64%	56%	65%	59%	62%	58%	60%	56%	60%	58%	61%	59%
NON-TOBACCO, %	38%	33%	37%	32%	36%	44%	35%	41%	38%	42%	40%	44%	40%	42%	39%	41%
HERF. INDEX	0.60	0.53	0.58	0.52	0.57	0.65	0.56	0.61	0.59	0.63	0.61	0.64	0.61	0.62	0.60	0.60

LOEWS CORPORATION TOBACCO AND NON-TOBACCO REVENUES AND INCOME

DATA FROM ANNUAL REPORTS:

	1979		1980		1981		1982	
	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME
PROPERTY & CAS. INS.	1,453	138	1,641	86	1,893	80	1,882	35
LIFE INSURANCE	1,058	58	1,152	31	1,089	26	1,135	26
HOTELS	175	39	229	82	240	102	161	34
THEATRES	46	8	55	12	60	13	64	14
WATCHES	166	9	197	3	180	5	151	(17)
CONSUMER FINANCE	139	54	150	50	145	32		
INVESTMENT INCOME	43	43	27	27	25	25	37	37
BROADCASTING (CBS)								
MISCELLANEOUS	33	5	31	21	37	22	14	6
REALIZED INV. GAIN		30		(31)		(20)		(17)
TOBACCO, TOTAL	951	112	1,053	159	1,109	178	1,173	229
DOMESTIC TOBACCO	951	112	1,053	159	1,109	178	1,173	229
INT'L TOBACCO	0	0	0	0	0	0	0	0
TOTAL	4,065	501	4,535	440	4,776	463	4,617	346
TOBACCO, %	23%	22%	23%	36%	23%	38%	25%	66%
NON-TOBACCO, %	77%	78%	77%	64%	77%	62%	75%	34%
HERFINDAHL INDEX	0.74	[illegible]	0.74	0.77	0.73	0.76	0.71	0.52

	1983		1984		1985		1986	
	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME
PROPERTY & CAS. INS.	1,951	42	2,254	(72)	3,222	130	4,863	168
LIFE INSURANCE	1,320	37	1,473	66	1,548	47	1,763	76
HOTELS	217	94	157	29	158	35	175	38
THEATRES	70	16	80	20				
WATCHES	152	(8)	148	12	171	34	181	36
CONSUMER FINANCE								
INVESTMENT INCOME	50	50	48	48	94	94	49	49
BROADCASTING (CBS)							11	11
MISCELLANEOUS	10	(2)	13	0	5	2	16	(1)
REALIZED INV. GAIN		(52)		51				
TOBACCO, TOTAL	1,490	253	1,431	282	1,501	326	1,563	433
DOMESTIC TOBACCO	1,490	253	1,431	282	1,501	326	1,563	433
INT'L TOBACCO							0	0
TOTAL	5,260	420	5,603	437	6,700	668	8,626	812
TOBACCO, %	28%	59%	26%	64%	22%	49%	18%	53%
NON-TOBACCO, %	72%	41%	74%	36%	78%	51%	82%	47%
HERFINDAHL INDEX	0.72	0.56	0.70	0.50	0.66	0.69	0.61	0.66

PHILIP MORRIS TOBACCO AND NON-TOBACCO REVENUES AND INCOME

DATA FROM ANNUAL REPORTS:

	1979		1980		1981		1982		1983		1984		1985		1986	
	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME
BEER	2,236	181	2,542	145	2,837	116	2,929	159	2,922	227	2,928	116	2,914	136	3,054	158
SOFT DRINKS	295	7	353	(7)	432	(2)	531	(1)	650	(11)	734	5	678	10		
PAPER & CHEMICALS	269	18	277	17	291	19	233	8	237	14	277	30	138	15		
LAND DEVELOPMENT	154	22	173	31	164	23	130	6		20		17				18
P.M. CREDIT								1		5		11				55
FOOD													1,632	116	9,664	740
TOBACCO, TOTAL	5,348	962	6,478	1,115	7,162	1,279	7,894	1,548	9,167	1,704	9,874	2,166	10,602	2,484	12,691	2,870
DOMESTIC TOBACCO	2,767	701	3,272	786	3,762	906	4,330	1,102	5,520	1,338	6,133	1,745	6,611	2,050	7,053	2,369
INT'L TOBACCO	2,581	261	3,205	329	3,400	373	3,564	446	3,647	366	3,741	421	3,991	434	5,638	501
TOTAL	8,303	1,191	9,922	1,300	10,886	1,434	11,716	1,720	12,976	1,958	13,614	2,346	15,964	2,761	25,409	3,841
TOBACCO,	64%	81%	66%	86%	66%	89%	67%	90%	71%	87%	71%	92%	66%	90%	50%	75%
NON-TOBACCO	36%	19%	34%	14%	34%	11%	33%	10%	29%	13%	29%	8%	34%	10%	50%	25%
HERF INDEX	0.51	0.32	0.50	0.25	0.50	0.20	0.48	0.18	0.45	0.23	0.44	0.14	0.51	0.19	0.59	0.40

RJR-NABISCO TOBACCO AND NON-TOBACCO REVENUES AND INCOME

DATA FROM ANNUAL REPORTS:

	1979		1980		1981		1982		1983		1984		1985		1986	
	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME	REVENUE	INCOME
FOOD PRODUCTS	1,962	128	2,265	94	2,334	100	3,156	102	4,491	334	4,698	391	8,533	763	9,236	820
TRANSPORTATION	1,220	58	1,414	66	1,623	103	1,583	157								
ENERGY	628	66	985	183	1,370	247	1,332	215	1,221	190						
PACKAGING PRODUCTS	195	15	205	11												
SPIRITS & WINES															1,303	138
MISCELLANEOUS					405	25	508	36	580	27	738	34				
LESS: INTERCO. SALES	(94)	(44)	(124)	(62)	(165)	(63)	(159)	(76)	(147)	(91)	(147)	(94)		(83)		
TOBACCO, TOTAL	5,033	864	5,609	978	6,124	1,093	6,655	1,160	7,388	1,127	7,685	1,288	8,062	1,483	8,996	1,659
DOMESTIC TOBACCO	3,183	720	3,521	801	3,968	914										
INT'L TOBACCO	1,851	144	2,088	177	2,157	179										
TOTAL	8,935	1,087	10,354	1,269	11,692	1,504	13,075	1,594	13,533	1,587	12,974	1,619	16,595	2,163	19,535	2,617
TOBACCO,	56%	79%	54%	77%	52%	73%	51%	73%	55%	71%	59%	80%	49%	69%	46%	63%
NON-TOBACCO,	44%	21%	46%	23%	48%	27%	49%	27%	45%	29%	41%	20%	51%	31%	54%	37%
HERF. INDEX	0.61	0.35	0.63	0.37	0.65	0.43	0.66	0.44	0.58	0.43	0.51	0.30	0.50	0.40	0.56	0.50

TOBACCO VS. NON-TOBACCO CAPITAL INVESTMENTS

AMERICAN BRANDS:

YEAR	1979	1980	1981	1982	1983	1984	1985	1986
CAPITAL INVESTMENTS:								
TOBACCO	48	93	78	68	60	63	62	85
NON-TOBACCO	74	95	83	79	76	101	107	168
TOTAL:	123	188	161	147	137	164	169	254
TOB. FRAC. OF TOTAL	0.40	0.50	0.49	0.46	0.44	0.38	0.37	0.34
ASSETS:								
TOBACCO	1,490	1,705	1,664	1,633	1,620	1,440	1,648	1,693
NON-TOBACCO	1,447	1,530	1,699	1,561	1,787	1,869	2,085	2,357
TOTAL:	2,937	3,235	3,363	3,194	3,407	3,308	3,732	4,050
TOB. FRAC. OF TOTAL	0.51	0.53	0.49	0.51	0.48	0.44	0.44	0.42
CAP. INV. AS % OF ASSETS:								
TOBACCO	3.25%	5.46%	4.70%	4.18%	3.73%	4.34%	3.79%	5.05%
NON-TOBACCO	5.12%	6.18%	4.88%	5.04%	4.27%	5.42%	5.13%	7.14%
TOTAL:	4.17%	5.80%	4.79%	4.60%	4.01%	4.95%	4.54%	6.27%

LOEWS CORPORATION:

YEAR	1979	1980	1981	1982	1983	1984	1985	1986
CAPITAL INVESTMENTS:								
TOBACCO	15	15	23	12	14	21	17	16
NON-TOBACCO	34	36	68	66	57	58	56	81
TOTAL:	50	51	91	78	71	78	73	97
TOB. FRAC. OF TOTAL	0.31	0.30	0.25	0.15	0.19	0.26	0.24	0.16
ASSETS:								
TOBACCO	583	576	577	558	566	592	541	561
NON-TOBACCO	8,260	8,549	9,337	9,838	10,944	11,965	15,578	18,464
TOTAL:	8,843	9,125	9,914	10,396	11,510	12,557	16,120	19,024
TOB. FRAC. OF TOTAL	0.07	0.06	0.06	0.05	0.05	0.05	0.03	0.03
CAP. INV. AS % OF ASSETS:								
TOBACCO	2.62%	2.63%	3.91%	2.09%	2.39%	3.48%	3.21%	2.81%
NON-TOBACCO	0.42%	0.42%	0.73%	0.67%	0.52%	0.48%	0.36%	0.44%
TOTAL:	0.56%	0.56%	0.92%	0.75%	0.62%	0.62%	0.45%	0.51%

TOBACCO VS. NON-TOBACCO CAPITAL INVESTMENTS

PHILIP MORRIS:

YEAR	1979	1980	1981	1982	1983	1984	1985	1986
CAPITAL INVESTMENTS:								
TOBACCO	197	378	557	499	320	163	151	191
NON-TOBACCO	386	299	305	286	175	94	158	475
TOTAL:	583	677	861	785	495	257	309	666
TOB. FRAC. OF TOTAL	0.34	0.56	0.65	0.64	0.65	0.64	0.49	0.29
ASSETS:								
TOBACCO	3,338	3,926	4,836	5,071	5,114	5,149	5,622	5,808
NON-TOBACCO	2,714	3,049	3,503	3,633	3,146	2,910	10,396	10,365
TOTAL:	6,052	6,975	8,339	8,704	8,261	8,059	16,018	16,173
TOB. FRAC. OF TOTAL	0.55	0.56	0.58	0.58	0.62	0.64	0.35	0.36
CAP. INV. AS % OF ASSETS:								
TOBACCO	5.90%	9.63%	11.51%	9.84%	6.26%	3.17%	2.69%	3.29%
NON-TOBACCO	14.22%	9.82%	8.70%	7.88%	5.55%	3.22%	1.52%	4.58%
TOTAL:	9.63%	9.71%	10.33%	9.02%	5.99%	3.19%	1.93%	4.12%

R. J. REYNOLDS:

YEAR	1979	1980	1981	1982	1983	1984	1985	1986
CAPITAL INVESTMENTS:								
TOBACCO	78	121	166	226	371	517	647	613
NON-TOBACCO	607	759	604	603	554	296	547	434
TOTAL:	684	880	770	829	925	813	1,194	1,047
TOB. FRAC. OF TOTAL	0.11	0.14	0.22	0.27	0.40	0.64	0.54	0.59
ASSETS:								
TOBACCO	2,044	2,233	2,735	3,094	3,240	3,668	4,496	4,883
NON-TOBACCO	4,378	5,123	5,361	7,261	6,634	5,604	12,434	12,136
TOTAL:	6,422	7,355	8,096	10,355	9,874	9,272	16,930	17,019
TOB. FRAC. OF TOTAL	0.32	0.30	0.34	0.30	0.33	0.40	0.27	0.29
CAP. INV. AS % OF ASSETS:								
TOBACCO	3.81%	5.42%	6.06%	7.30%	11.45%	14.09%	14.39%	12.55%
NON-TOBACCO	13.85%	14.81%	11.27%	8.30%	8.35%	5.28%	4.40%	3.58%
TOTAL:	10.66%	11.96%	9.51%	8.01%	9.37%	8.77%	7.05%	6.15%