



How Philip Morris Manages disruptive regulations and what other industries can learn from them.

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Portuguese Abstract

Como a Philip Morris gere regulações perturbadoras e o que as outras indústrias podem aprender com eles.

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Nesta tese apresentada em formato de estudo de caso, analisaremos o que aconteceu com a Philip Morris e como ela adaptou sua estratégia.

Em primeiro lugar, examinaremos a história do que aconteceu à Philip Morris quando o aumento da regulamentação interrompeu a maioria das práticas de marketing para todos os participantes da indústria do tabaco e analisaremos suas reações. Em seguida, analisaremos outros setores que estão passando por interrupções semelhantes e avaliaremos o que eles podem aprender com o que aconteceu com o PM.

Métodos usados: Analisaremos a indústria do tabaco por meio de uma série de entrevistas com especialistas da indústria para obter conhecimento interno de como as empresas de tabaco estavam lidando com tais interrupções, bem como analisar de perto a pesquisa existente.

Faremos então a mesma coisa com a indústria de álcool e alimentos/bebidas e veremos primeiro como eles se sobrepõem e o que podem aprender com o PM.

Depois de analisar de perto as pesquisas e entrevistas existentes, é seguro dizer que a PM e outras empresas de tabaco são mestres na arte de gerenciar mudanças disruptivas. Eles fazem isso investindo pesadamente em lobby, adaptando-se constantemente a novas leis e encontrando formas legais de contornar essas regulamentações e, finalmente, participando ativamente na redução dos danos aos fumantes por meio de investimentos pesados em produtos de risco reduzido. A indústria de álcool e alimentos / bebidas está enfrentando os mesmos desafios hoje e pode aprender muito com as estratégias implementadas pela PM para enfrentar interrupções.

Palavras-chave

Marketing, Regulamentação, Comunicação, Tabaco, Legal, Estratégia, Disrupção, Produtos de Risco Reduzido, Próxima Geração, IQOS, Capacidades dinâmicas.

English Abstract

How Philip Morris Manages disruptive regulations and what other industries can learn from them.

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In this thesis presented in a case study format, we will analyze what happened to Philip Morris and how they adapted their strategy in a disruptive regulatory environment.

We will firstly dig into the history of what happened to Philip Morris when increased regulation put a halt to most marketing practices for all players in the tobacco industry and analyze their reactions and switches in strategy. We will then analyze other industries that are experiencing similar disruptions and assess what they can learn from what happened to PM.

Methods used: We will analyze the tobacco industry through several interviews with industry experts to gain insider knowledge of how tobacco companies were dealing with such disruptions as well as analyzing closely the existing research. We will then do the same thing with the alcohol and food/drinks industry and see firstly how they overlap and what they can learn from PM.

After analyzing closely the existing research and interviews it is safe to say that PM and other tobacco companies are masters in the art of managing disruptive change. They do so by investing heavily in lobbying, adapting constantly to new laws and find legal ways around such regulations and finally the active participation in reducing harm to smokers by heavy investments in reduced risk products. The alcohol and food/drinks industry are facing the same challenges today and can learn a lot from the strategies PM implemented to tackle disruptions.

Key words

Marketing, Regulation, communication, tobacco, legal, strategy, disruption, reduced risk products, next generation, IQOS, Dynamic capabilities.

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List of abbreviations:

NGP: Next generation products

PM: Philip Morris

PMI: Philip Morris international

BAT: British American Tobacco

JTI: Japan Tobacco International

RRP: Reduced risk products

R&D: Research and Development

POS: Point of Sale

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1. Introduction

Tobacco regulation has been increasingly strict over the years from when it first started in the 1950's. Since this point PM and other tobacco companies have always tried to find alternative ways of marketing their brands to continue promotion by staying within the confines of the law. Today, this process has become near impossible especially in developed countries leaving tobacco firms little flexibility in terms of promotion. However, we will see that they still somehow manage and develop strategies to thrive in this hostile regulatory environment.

Meanwhile, other industries have been experiencing similar regulatory trends imposed from governments. The alcohol industry and food/drinks industry are now under more and more scrutiny after numerous studies point out the negative health problems caused by their products much like the tobacco industry.

The introduction of subsequent regulatory limitations forced PM to continuously adapt their business strategy in a matter that is consistent with dynamic strategic adjustments. The systematic transformation of their strategy forced the company to find new ways to create value, while being exposed to an increasingly hostile external environment regarding the main products that the company sells.

These continuous adaptations render this a particularly interesting case in the context of strategy and this dissertation aims at using it to illustrate the many lessons it can provide in management science. In particular, the case is interesting in the description of the creativity in the promotion of a product that is labeled increasingly harmful by regulators and society in general.

The dissertation describes in a case study style the story of PM over recent years. Several experts were interviewed to support the perspectives on the approach used by the company in their adjustments throughout the years.

1.1 PM

PMI is the largest cigarette firm in the world (excluding the Chinese National Tobacco Corporation). The company's headquarters are in New York, although it has operational offices in Lausanne, Switzerland, and Hong Kong. According to the Associated Press, Altria chose to split Philip Morris USA and its overseas operations to "free the international tobacco firm from the legal and regulatory restraints that its local equivalent, Philip Morris USA, faces."

PMI and its subsidiaries sold cigarettes, other tobacco products, and non-combustible nicotine-based products in nearly 180 markets in 2018. In 2019, the firm claimed 28.4 percent of the global market for cigarette and heated tobacco products, excluding the United States and China.

In 2018, the corporation held six of the top fifteen global cigarette brands. Marlboro (the world's bestselling international brand), PMI claimed a market share of at least 15% in 100 countries.

On August 27, 2019, global news outlets reported that PMI and Altria were considering a merger to reunite the brands that had split in 2007. However, the merger was called off the following month, following news that the FDA was considering a ban on flavoured e-cigarettes.

1.2 PM product portfolio

PM own and sell over 130 brands with Marlboro being their number 1 selling brand and biggest tobacco brand in the world, followed by L&M (4th best-selling brand in the world), Chesterfield (7th best-selling brand in the world), PM (11th best-selling brand in the world) and Parliament (14th best-selling brand in the world). These brands are their top selling brands but they also own; Virginia Slims, Benson & Hedges, Merit, Alpine, Basic, Cambridge, Bucks, Dave's, Chesterfield, Collector's Choice, Commander, Lark etc..

As for non-tobacco brands they created and own IQOS which is the top selling heated cigarette machine as well as the combined cartridges called "Heets". It also owns pharmaceutical

companies such as Vectura, OtiTopic and Fertin pharma in their effort to diversify, develop inhouse technologies and slowly move away from the sale of traditional cigarettes.

2. Timeline of warnings/bans being implemented

In this section we will see the evolution of laws being implemented in the U.S. to further understand the steps and challenges tobacco companies faced up to today. To homogenize this section, we will explore the U.S. only in order not to mix up events from countries across the world.

1947: Cigarette consumption was normative amongst men and women. However, in 1947 Alton Ochsner and Michael DeBakey published a paper linking smoking to lung cancer. (countertobacco.org, point of sale timeline, 20121)

1955: The federal trade commission prohibits advertisements that highlight health benefits stating they are false and deceptive. (countertobacco.org, point of sale timeline, 20121)

1957: The first U.S. surgeon general (Leroy E. Burney) published a report stating: “It is clear that there is an increasing and consistent body of evidence that cigarette smoking is one of the causative factors in lung cancer”. (countertobacco.org, point of sale timeline, 20121)

1964: Report from general surgeon linked smoking to death and disease. (countertobacco.org, point of sale timeline, 20121)

1965: Congress passed the cigarette labeling and advertising act (FCLAA), which requires warnings to be present on cigarette packs and advertising. Furthermore, the federal trade commission had to report to congress every year on the effectiveness of these measures and make recommendations for legislation based on their findings. (countertobacco.org, point of sale timeline, 20121)

1969/1970: The new Act called “The public health cigarette smoking Act” was passed. This Act prohibited advertising on both T.V. and radio. (countertobacco.org, point of sale timeline, 20121)

1971: The surgeon general proposed a federal ban prohibiting smoking in public spaces. (countertobacco.org, point of sale timeline, 20121)

1972: New report which addresses the dangers of secondhand smoke and smoking during pregnancy. (countertobacco.org, point of sale timeline, 20121)

1974: The state of Connecticut becomes the first state to implement smoking bans in restaurants. (countertobacco.org, point of sale timeline, 20121)

1980: The U.S. Surgeon General report brings attention to women and smoking stating that lung cancer surpassed breast cancer to become the first cause of cancer relating deaths amongst women. (countertobacco.org, point of sale timeline, 20121)

1984: The FDA approves “Nicorette” which is the first product that aims to replace cigarettes to help people quit. (countertobacco.org, point of sale timeline, 20121)-1986: A new group called “Americans for non-smokers Rights” is founded to educate and propose legislations to limit second-hand smoke exposure. (countertobacco.org, point of sale timeline, 20121)

1988: Ban on smoking on all domestic commercial flights. Another report based on over 2000 studies was published declaring that nicotine is addictive. (countertobacco.org, point of sale timeline, 20121)

1992: The “Synar Amendment” is passed which requires states to enforce laws prohibiting the sale and distribution of tobacco products to minors (under 18). States began receiving un-announced inspections and had to maintain a violation rate of no more than 20%. (countertobacco.org, point of sale timeline, 20121)

1994: Executives from 7 different tobacco companies had to testify in court. They said they believe nicotine is not addictive even though industry documents clearly show that they knew the truth all along. (countertobacco.org, point of sale timeline, 20121)

New report from Surgeon General noted that young people below the age of 18 are exposed to cigarette messages and ads through the POS (point of sale) displays. (countertobacco.org, point of sale timeline, 20121)

1995: The foundation called “The preventing Tobacco addiction Foundation” is created to reduce tobacco use through strategic communications and advocate for policy campaigns. (countertobacco.org, point of sale timeline, 20121)

1996: A campaign called “Campaign for tobacco free kids” was created to reduce tobacco use through advocacy campaigns. (countertobacco.org, point of sale timeline, 20121)

1998: This year was particularly bad for the tobacco industry with the creation of the “Master Settlement Agreement”. This agreement was signed by the 4 biggest tobacco companies at the time (PM USA, Brown and Williamson, RJ Reynolds, Lorillard). Under this agreement these companies had to make annual payments to the state as compensation to re-imburse the costs of medically treating people that were sick from cigarette consumption (\$206 billion over 25 years). The agreement also sets a set of rules with restrictions on advertising, marketing, and promotion. (countertobacco.org, point of sale timeline, 20121)

-2000: The federal ban on cigarette consumption on domestic flights is extended to international ones. (countertobacco.org, point of sale timeline, 20121)

2004: State attorney general helped shut down the marketing effort of Brown & Williamson which targeted African American youth through hip hop music giveaways as well as DJ competitions in major cities around the country. The government also funded the Nation Quitline which aims to accompany people in their effort to stop smoking. (countertobacco.org, point of sale timeline, 20121)

2005: The first global public health treaty called the “WHO Framework Convention on Tobacco Control” (FCTC) is created. This health treaty was created in the effort to attack the globalization of the tobacco epidemic. This treaty requires a comprehensive ban to be implemented by all participating countries on all tobacco advertising, promotion, and sponsorship. It is the first joint global effort to tackle tobacco consumption. (countertobacco.org, point of sale timeline, 20121)

2006: A new report from surgeon general stating that there is no risk-free exposure to secondhand smoke. The “Tobacco industry Racketeering Verdict”: This verdict states on August 17, 2006, that major companies were found guilty of racketeering. This means they were deliberately misleading the public about the health implications of tobacco consumption as well as secondhand smoke exposure and the addictive component of their product. (countertobacco.org, point of sale timeline, 20121)

2007: Studies showed that there were large disparities in POS advertising in different demographics. It showed that POS advertising was 2.6 times more POS advertisements in African American communities compared to white neighborhoods. (countertobacco.org, point of sale timeline, 20121)

2008: San Francisco becomes the first city to ban sales of tobacco products in pharmacies. (countertobacco.org, point of sale timeline, 20121)

2009: The “Family smoking Prevention and Tobacco Control Act” is created and becomes a law on June 22nd, 2009, and allows the FDA to regulate, distribute, manufacture and market tobacco products to protect public health. This act also banned the sale of flavored cigarettes as well as terms such as “light” or “mild” on tobacco packages.

Price increase from 0.39 dollars to 1.01. (countertobacco.org, point of sale timeline, 20121)

2010: New rule for youth protection with minimum 20 cigarettes per pack and banning sampling and self-service vending machines except in “adult only facilities”. (countertobacco.org, point of sale timeline, 20121)

2011: Intention from the FDA to regulate e-cigarettes. (countertobacco.org, point of sale timeline, 20121)

2013: Providence becomes the first city to prohibit price discounts for tobacco products. New York city passes a series of rules that target POS displays. It prohibits price promotions as well as coupons and sets a “floor” price of 10.50 per pack. It also increases penalties for selling cigarettes without a license. (countertobacco.org, point of sale timeline, 20121)

2014: The FDA proposes a “deeming rule” to extend their control over all tobacco products. (countertobacco.org, point of sale timeline, 20121)

2015: The “deeming rule” is finally passed. (countertobacco.org, point of sale timeline, 20121)

2017: Court orders “corrective statements” to be published as an outcome of the 2006 guilty racketeering verdict mentioned before. (countertobacco.org, point of sale timeline, 20121)

2019: On the 15th of August 2019 the FDA proposes a new rule that would require tobacco companies to put graphic health warnings on packages and paired with warning texts. (countertobacco.org, point of sale timeline, 20121)

2020: The FDA releases the final rule for graphic health warnings (11photos) stating it must cover at least 50% of the pack. (countertobacco.org, point of sale timeline, 20121)

2021: Cities such as Beverly Hills and Manhattan Beach start prohibiting the sale of all tobacco products by stopping to issue new licenses. Other cities will most likely follow. (countertobacco.org, point of sale timeline, 20121)

3. Framework analysis

This section presents a strategic analysis that frames the decisions PMI needs to undertake to adjust to the different regulatory changes. It is the starting point for the main background for the company’s actions and adjustments.

Strengths:

- PM has one of the best distribution networks compared to all other competitors. This means that almost wherever you are in the world you will always find Cigarettes from PM brands (Marlboro being the biggest).
- PM also maintains strong relationships with all retailers selling their tobacco and/or smoke free products. This allows them to be promoted in priority within the shops with their products being placed in prime locations as well as POS displays that stand out.

- Another main strength of PM is their very strong financial position. This year alone they had over 30 billion in revenue and 8.8 billion in profit. This allows them to have a lot of capital in reserve which can be used to deal with unexpected events such as legal battles as well as buying new pharmaceutical companies in their race for diversification.
- The company owns 7 of the top 15 cigarette brands in the world. These “Cash Cow” brands fund their expansion, R&D, and diversification strategy.
- As mentioned in the interview with Rui Minhos (appendix H.1) R&D is also a main strength. The team has made it possible for the company to present new products such as the IQOS which is a game changer in the industry.
- Lastly, In Robin Van Buurens’ interview he says that PMI also invests huge amounts of capital into PR and lobbying. This allows them to maintain some control over laws being implemented in certain countries. Furthermore, even if the law is implemented, they know about it before anyone allowing them to prepare and find solutions quickly.

Weaknesses:

- The first weakness that is true for all tobacco companies is the fact that they are indeed still a tobacco company. This prevents them from completing certain mergers and acquisitions as a lot of these companies do not want to be associated with large tobacco companies. This also makes them constantly involved in legal battles which cost a lot of money and creates a bad reputation for the company.
- Secondly, governments around the world are increasing bans making it more difficult for tobacco companies to operate.
- Another big problem is that even if they create a new healthier smoking device, it must go through governments authorization processes such as the FDA (Food and Drug Administration – USA), as well as long paperwork procedures. In the interview with Marco Ghiotto (appendix H.4) he mentions that this is a big bottleneck which slows the introduction of new products in the market thus costing time and money.

Opportunities:

- Firstly, the company should take advantage of the booming online space. Especially nowadays with online shopping increasing every year it is crucial to be in this space at the right time. It would be a big mistake to not invest in the online space as they could lose large amounts of sales.
- With technology being improved every day they can use it to make better more healthier smoking devices. Furthermore, technologies such as the interconnectivity of machines (internet of things) can drastically decrease their costs of production and operations thus improving their profit margin.
- Smokers, which were at first slow to adopt alternative smoking products are now adopting devices such as the IQOS exponentially. As mentioned in the interview with Rui Minhos (appendix H.1), people stop and re-start traditional smoking 7 times on average meaning it is not working and another option needs to be offered. This is a great opportunity for them as the IQOS is the best-selling heated tobacco product by a long shot thus allowing them to “steal” consumers from competitors which were smoking non-PM owned brands and start selling them firstly the IQOS machine but most importantly the now called “heets” (heated tobacco cigarettes) on a regular basis and gaining market share.

Threats:

- Competitors such as BAT are investing heavily in technology and R&D as mentioned by Jose Benikes in his interview (Appendix H.2). This means that whilst PM has a good position regarding alternative smoking products they can be made obsolete one day to the next if their competitors offer a new better product. For instance, BAT have recently attacked PM into justice for patent infringement. PM uses a similar mechanism that has been invented by BAT in their IQOS device which led to this legal battle. Even though they won most cases (Except in the U.S.A.) this should be a warning sign that they need to be ahead of the game technologically.

- Political and legal factors are amongst the biggest threats. Any political instability in a country can happen leading to sudden changes in legislation.
- Robin Van Buuren mentions that China has a state-owned cigarette industry which sell 40% of the cigarettes worldwide. This makes it near impossible for PM to tackle this big economy meaning they are missing out on a lot of sales.

3.2 Porter's 5 forces:

Threat of new entrants:

- Entering this industry demands a lot of capital and legal requirements which restricts the entry for a lot of potential entrants thus creating a solid barrier to entry. (Marco Ghiotto interview, 2021, appendix H.4) However, if there is a large differentiation factor new entrants are actually really successful. These companies are by the way often bought by big tobacco firms. For example, the e-cigarette innovative entrant "JUUL" entered the market by storm and were rapidly gaining market share. PM USA (Altria) then bought a 30% stake in the company to be an active player in this market.
- Economies of scale in the industry are hard to achieve which puts PM at an advantage. In addition, since they are working with low margins due to high taxes this advantage reinforces their place in the market.
- On the other hand, access to distribution networks is easy for new entrants. Making it easy for them to put their products on the shelves. However, PM maintain a great relationship with their distribution networks to make sure their products stand out in the shop.

Bargaining power of suppliers:

- There are a lot of suppliers in the industry and only a few main buyers meaning suppliers are a weak force in the market. This also means PM can have a lot of different suppliers in

the different countries in which they operate in order to increase efficiency and decrease transportation costs.

- Another reason why the power of suppliers is weak is the fact that they provide standardized, less differentiated products meaning PM has low switching costs and can easily change suppliers making them have power over them.
- Suppliers also don't provide a credible threat for forward integration in the industry.

Bargaining power of buyers:

- Because of the addictive nature of nicotine, buyers have relatively low bargaining power. This means that the price elasticity of demand is extremely low (like luxury items).
- We could say that switching costs are very low for buyers which might suggest they have power. However, most smokers (cigarettes + smoke free products) have a restricted number of choices and usually stick with the big brands as there is not much difference in price.
- On the other hand, whilst Marlboro users are brand loyal and willing to pay a slightly higher price PM should also offer cheaper brands to have the largest customer base possible, as mentioned in Robin van Buurens' interview (appendix H.3). They do this with brands such as L&M, Lark and Merit.

Threat of substitute products:

- Since PM is present in all markets with products delivering nicotine (cigarettes, IQOS, E-cigarettes) the threat of substitutes is low. Furthermore, since PM has a key role in the evolutions of nicotine products as well as the creation of new ones it makes it very hard for new companies to enter with a new substitute that delivers nicotine in a better and cheaper way. Therefore, PM needs continuous investments in R&D to stay ahead of competitors.
- The only real threat of substitute products comes from medical products such as nicotine patches and nicotine chewing gums which have the aim of helping people quit smoking. On

the other hand, these products show limited success in helping people quit meaning that if they don't manage to quit their best alternative is to buy products such as the IQOS and/or e-cigarettes.

Rivalry amongst competitors:

- As Jose Benikes said (appendix H.2), there are very few competitors in the industry who have a large market share meaning it is a highly concentrated market. This means that any move from any big player will be noticed. This is because since the market is an oligopoly, there are some “Cartel traits” that can be noticed; even if they don't openly collude, they basically know that if they make any bold move the other company will eventually do the same. This makes rivalry amongst competitors a weak force in the market.
- On the other hand, these big firms (PM, BAT, JTI) are in high competition to become market leaders (Jose Benikes interview, 2021, appendix H.2) and are in a race to come up with the best alternative smoking products. As mentioned before BAT just recently filed lawsuits in different countries against PM for patent infringement for the IQOS. This makes them enter in costly legal matters which can be a threat to their profits. However, this new market is growing every year which decreases the need to capture market share making these companies less likely to enter in competitive actions.

4. How did PM react to main disruptive legal episodes?

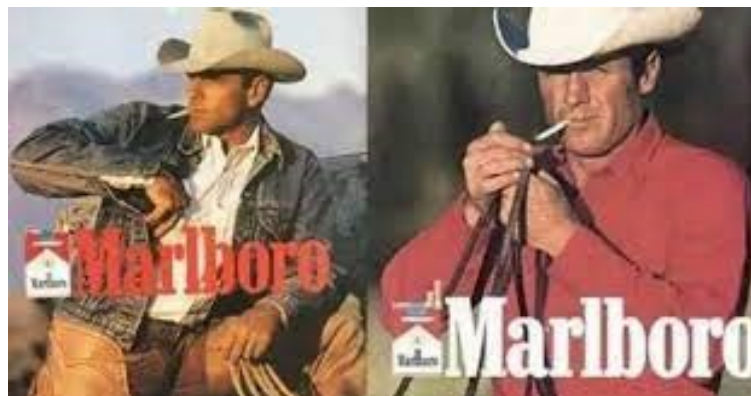
4.1. 1970 - The public health cigarette smoking act

As mentioned before this act was created to ban advertising on both T.V. and radio. Tobacco companies were left with no choice but to start finding other means of advertising. (Kenneth E. Warner, 1985) The first one is “print advertising”. Once the law passed the number of advertisements in the “Times” magazine (still permitted) more than doubled each decade until 1982 (see exhibit 1).

There was also an increasing number of anti-smoking campaigns on television which created social awareness on the dangers of tobacco. This is when the public started to truly realize that

smoking was dangerous. To manage this PM started to sell their “light” and “filtered” cigarettes. This is when the “tar wars” started where each manufacturer was showcasing their cigarettes with low “tar” content which was proven to be one of the most dangerous components in cigarette smoke. When the “tar wars” started “light” cigarettes went from 5% in 1970 to 60% a decade later (most sustained industry reaction) (Kenneth E. Warner, 1985). This increased consumption by 3 mechanisms: retaining users that would otherwise quit (Rui Minhos interview, 2021, appendix H.1), people smoking more cigarettes a day and making it easier for young smokers to start smoking. To market their “light” “low tar” cigarettes PM used the “Marlboro man” campaign to convince men to buy them too as they were initially perceived as more feminine. (See exhibit 2 below)

Picture B.1



(Times magazine, 2012)

As mentioned before, PM won this battle thanks to their “lifestyle marketing” efforts which were much more effective than the ads of other companies stating one brand of cigarettes is healthier than another. (Cameron White, John L. Oliffe, 2012)

There was also a clear trend of tobacco “smoke” being less visible on the print ads until completely disappearing in 1976. The main reason being that the public believed that smoke alone was dangerous. (Bruce Grant-Braham, John Britton, 2012) Another marketing effort they made is their Formula 1 sponsoring strategy. Since PM was not allowed to advertise cigarettes on T.V. they had to find another way to make their brand visible on the screens. They started sponsoring the “BRM” team in 1972 and made a widely successful marketing campaign: They sent journalists to a main event in France to capture the car coming out of a red Marlboro pack

(picture below). (Bruce Grant-Braham, John Britton, 2012) The campaign was extremely successful and made the headlines all over the world and tremendously improved their brand image.

Picture C.1



PM also had another great way to indirectly market their brand. They created a clothing brand which is now known as “Marlboro classics” (MCS) which they started in 1970 by opening a store. (Marketing week, 1997) The clothing line went hand in hand with the “Marlboro Man” by creating a clothing line that has a “manly” and outdoors appeal. The goal was not to make money out of the clothing brand but was purely a marketing strategy. (World Health organization, 2013) This was another way to go around the bans as people directly understood the link to Marlboro cigarettes. PM also had other strategic visions: In 1970, PM made the first of several acquisitions with the purchase of Miller Brewing Company. As they saw laws and bans becoming tighter for cigarettes, they decided to diversify into different markets such as the food and alcohol industry. (Maribeth S. Metzler, 2009)

4.2. 1990: Loi Evin in France leads the way for Europe and then the world

According to this law, all packets of cigarettes must display a health warning, a limit is imposed on the tar content of cigarettes, no smoking in closed public places, bans any advertising of tobacco, including on billboards and prohibits the free or promotional distribution of cigarettes. Tobacco advertising is also forbidden at sporting events, and televised coverage of foreign sporting events must make every attempt to hide similar sponsorship advertising that may be

present. The law was introduced in France and soon after adopted in many European countries. (A Rigaud, M Craplet - The Globe, 2004)

This was a huge step in terms of restricting almost all forms of promotion for tobacco companies which again had to adapt. This is when PM started to sponsor the Formula 1 Ferrari team (they also had McLaren). It was a no-brainer to be associated with Ferrari firstly because of their common color “red” which even if no logos are used people still make the connection to the company. (Bruce Grant-Braham, John Britton, 2012) Secondly, the association to the Ferrari team also added to their brand image by showcasing the values of luxury, speed, danger... This marketing trend has proven to be extremely effective and has been used from the company ever since they invented it in 1954 with the “Marlboro man”. (Bruce Grant-Braham, John Britton, 2012) Of course, they also continued their “Marlboro classics” clothing line as it was still one of the available loopholes to advertise their brand. (Mary Ann Benitez, 2007)

Another advertising strategy that they continued to adopt but increased expenditure in was POS advertising (depending on the country). (Tobacco Control 2001). This was still a grey area in the law and allowed companies to do in-store banners of products/brands. There was also a big effort made in merchandising where PM made sure their products were placed in the most prime locations in every store in the counter at eye level for example (Jose Benikes interview, 2021, appendix H.2). It also encouraged every tobacco shop to prioritize the sale of Marlboro instead of their competitors’. (Tobacco Control, 2001)

All in all, this is when PM and other tobacco companies had to start becoming creative and finding loopholes or new “indirect” ways of doing marketing.

4.3 2003-2005 FCTC and EU tobacco advertising directive

These two treaty/directives will be put together as they are somewhat connected, happened in the same timeframe, and have similar guidelines.

FCTC WHO framework:

As mentioned before this treaty requires a comprehensive ban to be implemented by all participating countries on all tobacco advertising, promotion, and sponsorship. 168 countries have signed the treaty. (*WHO FCTC, 2003*)

EU tobacco advertising directive:

The Tobacco Advertising Directive (2003/33/EC) introduces an EU wide ban on cross-border tobacco advertising and sponsorship in the media other than television which was already banned. The ban covers print media, radio, internet, and sponsorship of events involving several EU countries, such as the Olympic Games and Formula One races. (Standing committee of European doctors, 2006)

How did companies react?

JTI (one of PMI's main competitors at the time) pulled out of the Formula 1 following directives from the Japanese government because they thought it was too risky. (Marco interview, 2021, appendix H.4)

However, PM came up with a very clever strategy: They publicly said *“The Marlboro sponsorship is going to comply with the rules and regulations wherever we do business. There are countries where tobacco sponsorship is obviously not allowed. In those countries we will continue to support Ferrari without branding”* (Maribeth S. Metzler, 2009) What they did next to comply with the legislation is instead of using the official Marlboro logo, they used “bar codes” (still legal) (Maribeth S. Metzler, 2009) that were aligned in such a way that you could still recognize the Marlboro logo when the car was moving. No matter how sneaky or un-ethical this strategy is, it was brilliant You can see that the logo in the middle (when the car is on the move) is very close to the original logo. (see picture below).

Picture C.2



All this to show the importance of lifestyle marketing creating emotions and brand identity versus showcasing the actual product.

In market research, F1 is characterised by descriptors consistent with a perception that the sport is inter- national, expensive, glamorous, challenging, fast, furious, and dangerous which resonates in peoples' minds. Furthermore, the F1 Racing magazine reported that internal research had shown that Marlboro's red barcode created a stronger association with consumers than the previous original logo. (B Grant-Braham · 2012)

This worked so well that it was noticed from their main competitor (BAT) which said in an internal document: *“Current practice in the F1 environment shows that competitive brands develop alternative logos. These alternative logos are as close as legally possible to the brand logo. In the case of PM, letters are changed into straight black lines with different width”*. (B Grant-Braham · 2012)

5. Strategy

5.1. PM Strategy

PM's current strategy is simple and well-illustrated on the front page of their website: “Our goal is to deliver a smoke-free future”. (PMI, 2020) The first step they are taking is to announce their ambition for smoke-free products to account for more than 50% of their total net revenues by 2025 (PMI, 2021). Initially this ambition was targeted at between 38% to 42% in 2019 (included in their 2019 integrated report) and raised to 50% during their “virtual investor day” on February 10th, 2021. To make this happen they aim to commercialize IQOS in 100 markets by 2025, up from 64 markets in 2020. (PMI, 2021) Their initial plan is to develop, market, and sell the best smoke-free alternatives to help adults who would normally continue smoking traditional cigarettes to switch to these alternatives as quickly as possible around the world. (JS Yang, RE Malone, 2008)

This will be a gradual process which requires the transition of the companies' resources from

cigarettes to smoke free alternatives meaning the whole supply chain has to change alongside the adoption of these new smoking alternatives. Of course, this will only be possible if governments and their relevant regulatory bodies accept these new products being distributed and marketed correctly in order to make all current smokers aware of these new safer alternative products. Indeed, even though it might seem unethical to promote these types of products initially, it would be even worse if people are not aware or given the chance to switch to safer options (R. Minhos interview, 2021, appendix H.1). As a result, PM is actively working alongside regulatory agencies to propose regulatory policies that encourage the replacement of traditional cigarettes with these reduced risk alternatives as mentioned in the interview with Rui Minhos (appendix H.1)

PM launched a 10-year plan entitled “Normalisation” with the objective to “*establish PM as a trusted and indispensable partner, leading its sector and bringing solutions to the table*”. (PMI, 2018). To achieve this, it would establish a “forward-looking, motivational and credible” purpose statement. It would also “balance the debate” by exposing the “double standards” of anti-tobacco campaigners and amplifying the voices of people who favoured harm reduction and those supporting the fact that smokers deserve alternative products. PM planned to create and maintain relationships with politicians, international organisations, NGOs, academics, scientists, researchers, and the media, to promote its new purpose and products. (M. Davies, et., al, 2020)

Part of their transition also lies in their diversification strategy. Indeed, PM are also planning to expand to the pharmaceutical industry as part of their vision called “Beyond Nicotine”. As mentioned before they have already acquired 3 of these pharmaceutical companies (Fertin Pharma, OtiTopic and just recently Vectura). (PMI, 2021) Another important aspect of their current strategy is “Transparency”. They are sharing their progress and invite dialogue with industry experts, scientists, and the public. They also welcome independent verification in an effort to not repeat the errors they made in the past by hiding information such as their knowledge that nicotine was addictive, and that cigarette smoke causes diseases. (R. Minhos interview, appendix H.1)

All in all, we can see that PM is actively acting on their goal to eventually become a smoke-free company and are publicly accepting the “death” of cigarettes in the future which is why

they are preparing themselves to be present in other growing industries instead of falling alongside the one they have been operating in for years. (Rui Minhos interview, 2021, appendix H.1)

This is a great example of a company that has accepted change and gone with it instead of fighting it. It would be the perfect counter example of Kodak who didn't accept the change in the market and tried to fight it which ultimately led to their failure. From an investors perspective this is good news and has proven to be effective as their share price has been steadily growing over the years. (Yahoo Finance, 2021)

Marketing:

From a Marketing standpoint PM most recently initially used the internet and/or social media platforms to market their products thanks to the fact the internet is still very much un-regulated. However, PM is making sure that their online marketing operations do not target young people which is why they self-retracted from social media platforms in 2019 after they faced some backlash from anti-tobacco groups that were accusing them of marketing their IQOS device to young people by using influencers under the age of 25. (C. Kirkham, 2019). This was most likely done to prevent any further backlash from governments which will eventually end up regulating this space. This shows that they somewhat learned their lessons from the past which also helps their lobbying efforts by showing regulators their goodwill. Furthermore, the e-cigarette company "JUUL" where Altria (PM USA) owns a 30% stake has agreed to settle a lawsuit of 40 million dollars that accused them of marketing their addictive products to minors through social media. (Stanton A. Glantz, 2019) This served as a good example to not do the same.

As we can see, nowadays there is a very limited amount of marketing communications channels available for PM. However, they still exist. PM still sponsors the Formula 1 Ferrari team to this day. In 2018 they started their "Mission Winnow" campaign alongside the Formula 1 team. This campaign showed a logo with an arguably subliminal hint to the Marlboro logo with its triangle shape. (See picture below).

Picture C.3



The Mission “Winnow” has the goal to showcase the companies’ vision for a better future without cigarettes and is meant to put into light their efforts to create positive change. As PMI’s CEO Andre Calantzopoulos said,

“We will use this global platform as a window into the new PMI and to challenge preconceptions, as we know there are many who may have doubts about us and our motivations. Our partnership with Scuderia Ferrari gives us the opportunity to build on many encouraging individual conversations with critics and supporters alike and reach out to a broad audience to engage at scale” (PMI, Annual Report2019).

However, we cannot deny that even though this may be true, the “Winnow” logo still resembles the Marlboro logo which ultimately lead critics to say they were using subliminal advertising techniques. (John Baker, Pascal Diethelm, 2019). In 2015, the Grand Prix Drivers Association conducted a fan survey with 130,000 participants from 194 countries. Respondents were asked to recall five brands that sponsor F1. Nearly 8 years after the last active display of Marlboro on the Ferrari F1 cars, the brand was still recalled by 24% of participants. (John Baker, Pascal Diethelm, 2019).

PM denies such accusations but have removed the logo in countries where they faced the most backlash such as Australia but continue to use it in other countries such as Dubai. Another marketing opportunity being available to them now is the promotion of their heated

tobacco product “IQOS”. PM are relying on IQOS a lot more for a good reason: Even though e-cigarettes present fewer risks to the consumers’ health (still very close), the margins of selling such products and its liquids are extremely small. Therefore, selling the compatible heat sticks makes more economic sense as it enjoys much bigger margins, are easier to manufacture and enjoy less taxation compared to traditional cigarettes thus increasing margins even more. (M. Davies, et., al, 2020) This product enjoys much less regulation since it is simply an electronic device which can be promoted in several different ways. (Carla J. Berg et., al, 2021) Firstly, they have pop up stores emerging in cities to promote and educate people about the product. These stores have a glamorous and sophisticated feel to the much like Apple stores. (See picture below)

Picture D.2



These stores are an integral part of their strategy not only to make people aware of their new product and help them switch to it but also creates a lasting impression which ultimately benefits their brand image. (John Baker, Pascal Diethelm, 2019) Similarly, they have their own smoking lounges in airports with a similar glamorous and innovative appeal. Another way they use the flexibility of the law applied to IQOS is doing outdoor advertisements, POS displays (especially in duty free stores and tobacco shops), sponsorships and events. (Robin Van Buuren interview, 2021, appendix H.3). They sponsor music events and usually have a large “IQOS” logo behind the DJ. (Y Bar Zeev, et., al, 2019)

An example of a recent event is 2019’s Djakarta Warehouse Project, one of Asia’s biggest dance music festivals where IQOS had lounges and POS areas to promote the brand to more than 90.000 young people. Throughout the festival there were bright Marlboro signs over bars and benches where people sat smoking. There was a Marlboro “Discover Room” with interactive red, blue and yellow booths, echoing cigarette branding, and an arcade game. The

festival's shops sold only Marlboro-branded cigarettes and the company employed attractive saleswomen to roam around promoting the products. (M. Davies, et., al, 2020)

They are also trying to create a “hype” effect around the product by allowing consumers to customize their own machines by assembling different parts together as well as creating “limited edition models”. This also allows to create a community of users who can exchange and show off their latest combos. (See pictures below)

Pictures D.3 and D.4



Rui Minhos mentioned in his interview (appendix H.1) that users can also “borrow” the machine free of charge for 1 week and give it back if they are not satisfied. IQOS also has several Instagram accounts as well as an “IQOS family” account which is a community of IQOS users from around the world (not operated by PM). However, they have stopped using influencers to market their products after facing backlash. (C. Kirkham, 2019)

As mentioned before, this communication is only allowed for the IQOS machine and is forbidden for its “HEETS” cigarettes which are the compatible cigarettes that go into the machine even though they go hand in hand. To the benefit of PM these HEETS cigarettes are taxed a lot less than traditional cigarettes depending on the country. For example, in France a pack of normal cigarettes is about 10.50e whereas a HEETS pack is only 7euros. (appendix D.5)

For the moment PM is capitalizing on the fact that the rules are still flexible but are also preparing for upcoming regulations that will most likely (as history has shown) start prohibiting

the promotion of such devices (Jose Benikes interview, 2021, appendix H.2). Eventually, most likely all types of product communication will be banned for smoking related products and devices. Since this would apply to all companies it is not necessarily a bad thing since they could spend the millions initially invested in marketing and use it to make better reduced risk products. (Harvard T.H Chan, the future of e-cigarettes, 2019)

Leadership:

It is important to consider how PMI executed this new strategic direction. One less obvious, but critical action taken by PMI was the complete change in the composition and profile of the leadership team. (Robin van Buuren interview, 2021, appendix H.3)

Historically, all senior posts in PMI were almost without exception occupied by “lifers”, i.e., people whose careers and expertise were formed from within the company. However, recently you can clearly see a change with senior posts in the company being filled with experts from outside of the industry. The current “Leadership team”, as shown on the company website, comprises twenty-three members of which only eleven (48%) could be called PMI “Lifers” or coming from the tobacco industry, the remaining twelve members come from outside of the tobacco industry. In comparison, the 2010 the annual report shows the leadership team to be made up of sixteen members of which fourteen (87,5%) all worked for the majority of their careers in PM, PMI or other tobacco companies.

Clearly this increase and diversification of the leadership team was needed to bring in the expertise to enable the company transformation, with specific roles in life sciences, medical research, product design, development and sourcing for the new Heat not burn products. Robin Van Buuren also mentioned that whilst he was working at PMI they also hired “outsiders” for the CFO role, Senior VP Operations, legal, Strategy, External affairs, communication and digital strategy. For a company such as PMI this was a significant change and clearly demonstrates the understanding by the board of directors that the “old team” was not equipped to achieve the new strategy and that new thinking and skills were needed.

5.2 Limitations of this strategy

As mentioned by Jose Benikes (appendix H.2) who worked for BAT in the past PMI's "smoke free" future sounds good and benefits their brand image but the extent to which this is attainable is still to be proven. Its revenues from alternative products shot up from 0.2% in 2015 to almost 20% in 2019, but the vast majority still came from cigarettes. The company sold more than 740m cigarettes worldwide in 2018 and is only reducing its production by a few percentage points a year. (M. Davies, et., al, 2020)

This means the adoption rate of alternative products needs to increase exponentially to fulfil their goal. All in all, they basically are dependent on the fact that people will switch to new generation products and stick to them which is a bit of an over-ambitious goal. (M. Daube,et., al, 2017) "*The multibillion-dollar tobacco industry will do everything they can to stay in business,*" said Dr Vinayak Prasad, head of the World Health Organization's tobacco control division. He believes that what PMI is saying is far from reality. André Calantzopoulos the executive chairman has also repeatedly reassured investors that PM wants to remain a leader in cigarettes and will not give up market share to its competitors. It has also launched legal action against anti-smoking policies in countries like the Philippines and has carried on advertising cigarettes in countries that permit it. (M. Davies, et., al, 2020)

Furthermore, developing nations around the world are starting to smoke at increased rates which is a good opportunity for tobacco companies as a whole. (J. Mackay, J. Crofton, 1996) This means that whilst there may be increasing amounts of people in developed nations adopting next generation devices, the adoption rate of traditional cigarettes in developing countries will off-set this goal. Furthermore, developing countries usually have a much bigger population than developed nations. This means the adoption rate of traditional cigarettes in these countries will off-set the adoption rate of next generation products in developed nations. For example, in Indonesia which is one of the biggest markets (see figure below). (Putu Ayu Swandewi Astuti,, et., al, 2020)

Picture E.1



You could argue that such companies will try and give consumers of developing countries the ability to buy reduced risk products, but this is unfortunately not possible on the broad scale. The first reason is the initial price of these devices which is way too expensive for most people living in these countries. (R. Minhos interview, 2021, appendix H.1). The second reason is that all smoke-free devices require electricity plugs. Which a lot of people don't have thus making the devices worthless. Rui Minhos also mentioned (appendix H.1) that when PM was talking to government officials in Rwanda, they found that most people cook with fire and smoke which is then unfortunately inhaled. This smoke is even more dangerous than traditional cigarettes meaning that even with all the efforts in the world to convert people to reduced risk products it would make no difference since the benefit of switching will be offset by the diseases they catch whilst inhaling the smoke from the fire pits. (R. Minhos interview, 2021, appendix H.1).

Another interesting thing is that as mentioned before, PM sponsored a big music festival in Jakarta Indonesia in 2019 with the "Marlboro" brand (alongside IQOS) being present everywhere. They also had lounges and POS areas where only PM products were sold. This shows that PM has no intention in reducing traditional cigarette consumption in these countries and are even promoting them very aggressively. (M. Davies, et., al, 2020)

Another limitation that is very relevant right now is the fact that PM's most powerful competitor (BAT) owns the patent of a component of the IQOS (Jose Benikes interview, 2021, appendix H.2). They have just recently won a trial in the U.S. meaning PM cannot import the IQOS anymore. (The wall street journal, 2021) Even though they have won the same trials in other countries such as the U.K. (Alex Baldwin, 20121), this poses a threat in the future for this specific product category which they are relying upon and have spent billions for. It is also

their “star” product that they hope will help the company achieve its goal of having more than 50% of their revenues coming from next generation products. (PMI, 2021) However, BAT is not selling their “GLO” device in the U.S. leading PM USA to say that this ruling goes against public health as current IQOS smokers will be forced to go back to traditional cigarettes which are more harmful. (Rui Minhos interview, 2021, appendix H.1)

5.3 Competitors Strategies

As mentioned before the main competitor of PM is BAT. BAT is following a very similar path with their heavy investment in next generation products and diversification into pharmaceutical companies although their communication differs slightly. Indeed, BAT are not making the same bold claims as PM who say they want to stop selling cigarettes in the future. BAT recognizes that this is a bit far-fetched and prefers communicating the fact that they are actively trying to make a difference but are not promising that they will move away from cigarettes any time soon. (J. Benikes interview, 2021)

F1 sponsorship: The first similarity in marketing strategy is their sponsorship of the McLaren team (previously sponsored by PM). They stopped sponsoring the formula more than a decade ago but saw that PM was still in the game and making it work so they decided to make a comeback. (Marco Ghiotto interview, 2021, appendix H.4) They too have a logo that tries to showcase the fact that the company is working on making a positive change in the world with their new logo/slogan “A better tomorrow” (M. Baker, 2020) (see picture below)

Picture F.1



In a way, BAT lets PM face the backlash first and then decides to retract their logo from the car depending on which countries have attacked PM on theirs. For example, during the 2019 Australian Grand Prix they voluntarily decided to remove the logo from the car because they knew the Australian government was hostile with PM and their logo the year before. (R. Welberg, 2019)

Another reason BAT is adopting the same strategy as PM is their heavy investment in reduced risk products and the fact they are also slowly moving away from traditional cigarettes. They have a large portfolio of e-cigarettes and their “VUSE” e-cigarette which is the number 1 e-cigarette brand globally (BAT, 2021) and is competing hand in hand with “JUUL” e-cigarette which is owned by Altria (PM USA). They are also heavily investing in their “heat not burn” product called “GLO” which is now competing with IQOS even though IQOS is still way ahead in terms of users and availability/distribution. (J. Benikes interview, 2021) In this category of products BAT and PMI are in legal battles over the patent of their products. BAT has also used heavy lobbying tactics as a strategy. For example, in Kenya in 2007 where the government wanted to implement similar restrictions already applied in Europe such as increased taxes and health warnings on packages. BAT interfered with the policy makers and ended up delaying the implementation of the law for 13 years. When the High Court ruled against BAT, they took the case to appeal in 2016, and then to the Supreme Court in 2017. On 26 November 2019, the Kenyan Supreme Court, the highest legal authority, ruled to uphold the regulations. This goes to show the power of the tobacco industry where they have the resources and tactics to influence the law of a country.

6. Analysis of PM through the dynamic capabilities framework

Recent research shows that the average period for which firms can sustain competitive advantage has decreased over time (Wiggins & Ruefli, 2005). This is no surprise since today's world is changing at a very fast pace. This said, companies need to constantly adapt to this change by changing their internal structure as well as adapting their strategy to external forces. Failure to adapt to these environmental changes often leads to the failure of big companies

which are engrained in a old style management routine (Audia, Locke, & Smith, 2000). For example the company Kodak failed at this which lead to their collapse.

Teece et al. (1997) defined dynamic capabilities as *“the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments”*.

1. First, they categorized the nature of the concept as being an “ability” (or “capacity”). (Wiggins & Ruefli, 2005)

On this point PM has proven that it is able and capable of managing this. They do so by recruiting the best skilled workers and having large amounts of capital that is directed towards dynamic capabilities instead of trying to sustain a business model that is becoming obsolete. They have also shown that they are able to make bold moves like completely changing the structure and orientation of high management.

2. Second, they specified the desired end (i.e., the role) of this special capability as being to integrate (or coordinate), build, and reconfigure internal and external competences. (Wiggins & Ruefli, 2005)

Internally PM has changed their whole management and culture in order to re-direct itself in this changing environment. They are also doing their own scientific studies internally. Rui Minhos for example is conducting a survey in Portugal with over 10000 respondents to assess the adoption rate of their reduced risk products. Externally, they have embraced social changes such as the reduced acceptance of traditional cigarettes and made big investments into products that satisfy the new needs and wants of their consumers.

3. Third, they focused on a particular type of external context, namely, rapidly changing environments. (Wiggins & Ruefli, 2005).

As mentioned, before they embrace the fact that people do not want to smoke traditional cigarettes anymore. They also adapt very quickly to the increasing amount of technology which is being made available in the market. This is a very crucial point because if they do not keep up with the evolving technology industry they will ultimately fall behind.

You could also argue that the external regulatory policies are the main drivers of the industry. This means tobacco companies need to constantly change and adapt their practices to make the most out of what is permitted by staying within the confines of the law. A very good example of PM doing this is their constant change in logo visible on Ferrari Formula 1 cars: Every time the law posed a new regulation on this they found clever ways around them thus constantly adapting to the external disruptive legislative sector.

4. Fourth, they assumed that dynamic capabilities are typically built rather than bought. (Wiggins & Ruefli, 2005)

Even though this transition is very costly in terms of R&D we can see that the company is actively re-building itself from within and building new strategies that no-one would of thought of just 5 years ago. Furthermore, they are not only re-building themselves to adapt to the market but are being a pro-active force in the industry for the good of its consumers. They have shaped the direction of the industry with competitors following in their footsteps. Even though money can help companies have the courage to make such bold moves, it ultimately has to be built from within the company into the mindset of every employee so that everyone works towards the same common goal.

5. Finally, their approach explicitly stated sustained competitive advantage (or success vs. failure, or value creation) as a direct outcome of dynamic capabilities. (Wiggins & Ruefli, 2005)

We have clearly seen throughout this study that PM is the most dynamic company in the industry by making all the main strategic decisions first with competitors following. These decisions include constant and heavy investment in new technology, the acceptance of the death of cigarettes in the near future, their diversification into the pharmaceutical industry and their active participation in the legal landscape. This is therefore no surprise that they are the leading tobacco company in the world. They have managed to sustain this competitive advantage throughout the years and show no signs of slowing down which is why their stock price has always been steadily growing making investors satisfied.

7. Comparison with liquor industry

7.1 How do both industries compare?

The first main difference with tobacco is that when alcohol is consumed moderately it has very limited health impacts (Martijn Van Buuren interview, 2021, appendix H.5) whereas for tobacco even 1 cigarette a week can cause serious long-term illnesses. (B. Hawkins, 2018)

However, there is an increasing recognition of the health harms caused by alcohol. While tobacco remains the leading cause of avoidable death globally, responsible for around 5.4 million death per year (8% of global mortality), alcohol causes an estimated 3.3 million deaths a year. (5.9% of global mortality) and accounts for 5.1% of the global burden of disease measured in disability-adjusted life-years (DALYs). (B. Hawkins, 2018) In addition to the health harms, alcohol is the cause for several socio-economic problems. Thus, while tobacco harm exceeds those of alcohol, the latter is harmful enough, and similar enough to tobacco, that the current divergences in regulation and in approach to the industries seem unwarranted.

However, there are similarities in responses to disruptions from both industries.

A similar response alcohol companies are now implementing is the introduction of 0.00% alcohol beverages or ones that have a very low alcohol content that imitate traditional alcoholic drinks such as beer, wine, or other spirits. (Martijn Van Buuren interview, 2021, appendix H.5). This mirrors the tobacco industries' response when they introduced their "light" cigarettes. The low or non-alcoholic beverage is expected to grow 34% in volume by 2024 (L. Eads, 2021) making it a no-brainer for alcohol companies to invest in this growing market segment. From the "dynamic capabilities framework this showcases the ability and willingness of alcohol companies to change certain parts of their business in response to changing external social factors. Martijn Van Buuren mentioned this a lot saying it is the next big market to tackle (appendix H.5)

However, even though the response is the same as tobacco companies that came up with the "light" cigarette these products don't actually pose any risks since the main dangerous

ingredient (alcohol) has disappeared whereas “light” cigarettes were still as dangerous if not more since people ended up smoking more of them. (S. Shiffman, et., al, 2001).

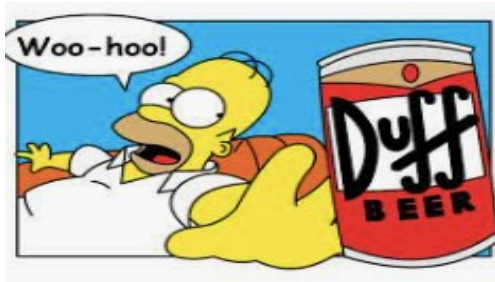
7.2 Strategies

Alcohol companies have been criticised for producing incomplete and distorted views of the evidence showing the dangers of alcohol and have been influencing research funding and publications in biased ways for their economic interest. (E. Tanner-Smith, R Polanin, 2015) These tactics mirror those of the tobacco industry. Unlike the tobacco industry, which has been excluded from direct influence in policy making in many countries, alcohol industry actors continue to have strong influence on alcohol policies across the globe (Martijn Van Buuren interview, 2021, appendix H.5) For example, they have been implicated in the actual drafting of policy documents in low-income countries and can lead public education in high-income countries (exactly like cigarette companies in the past). (Jim McCambridge, et. al., 2013)

7.3 Marketing Decisions

Alcohol companies argue that promotion and advertising causes consumers to switch from brand to brand instead of creating increased consumption (Martijn Van Buuren interview, 2021, appendix H.5). According to the Scottish beer and pub association “*the overwhelming consensus of academic studies in this area concludes that it does not drive overall increases in category consumption in the total population*”. There is evidence, however, that advertising bans or censorship have been ineffective. These findings are still debated, and other groups say that alcohol companies are choosing to highlight studies that support their claims. (Jim McCambridge, et. al., 2013) We can also see clear similarities in both industries regarding the heavy investment in youth targeted advertisements. This is because consumers are often very loyal to the brand of the first cigarette they smoke or the first drink they drink. (DiFranza et al., 1994). Therefore, firms within these 2 industries compete with their competitors to attract young consumers that will become life-long consumers. Therefore alcohol and tobacco companies even placed their brands in tv shows which a lot of kids watch such as “The Simpsons” with “Duff Beer” or in “camel Joe” with “Camel cigarettes. (See pictures below)

Picture G.1



Picture G.2



Like cigarette companies in the past, alcohol companies are investing heavily into sport (D Bjelica, et., al, 2016)

This is also because a lot of young people watch it and are thus influenced by such advertisements. For example, a study found that people who practice sport are more likely to drink and participate in heavy episodic drinking in comparison to those who do not play sports. (A. Bedendo, Ana R. Noto, 2015) This is why the brand “Heineken” is visible during big football competitions as it is seen by a huge amount of people including young people that will be sub-consciously attracted to their product when they start drinking in the future. In terms of what is permitted, the alcohol industry is a lot more free than the tobacco industry which has almost fully retracted from such sponsorships (except for the Formula 1). However, increasing regulation will slowly limit such freedoms in advertisements like it did for tobacco companies. (T Chambers · 2021). The “dynamic capabilities of such companies will be put under test when this happens which is why they have to work on future alternative strategies and/or restructuring plans

Party events: In the 90’s tobacco companies were present in bars and nightclubs and doing promotions such as handing out free samples, advertisements all over the bar and having attractive people talk about and smoke the product. (Nancy A. Rigotti, et al., 2005) Right now, alcohol companies spend \$1.54 billion a year in music festivals sponsorships alone. (A. Robertson, 2020) Festival goers tend to like brands that sponsor music festivals with 93% indicating they liked the brands that sponsored such events; 80% said they were more likely to buy a product after engaging with them at a music festival, and 37% believed they had a better overall perception of the brand after the experience. (A. Robertson, 2020) Marketing

regulations in festivals, bars and nightclubs are still flexible making it a great opportunity right now for brands to showcase their products. However, much like the tobacco industry before, these rules will tighten up in the future meaning companies have start looking in advance what tobacco companies did next. (JD Spivey, et al., 2018)

8. Comparison with fast food industry

Nowadays, regulators (especially in the EU) are imposing new bans on industries selling processed foods, junk foods and sugary drinks. For example, in the UK it is prohibited to advertise junk foods before 9pm which is aimed at protecting children. (Junk food is the new tobacco': experts call for restrictions to tackle obesity, 2020)

However, companies can still advertise itself without showing actual food. This has led them to copy PM's "lifestyle marketing" model of the Marlboro man. (Marco ghiotto interview, appendix H.4) For example, Coca Cola showcase young people full of joy and energy and McDonalds showcase fun family moments. This is the same strategy that PM implemented: Instead of trying to show why their products are not that bad they create feelings and emotions around the brand which resonates much more in people's minds. Similarly, to the tobacco industry in the 70's, now that studies discovered that bad diets and fast-food consumption causes about 11M preventable deaths a year (*GBD 2017 Diet Collaborators*), regulators are starting to impose new rules that follow the same strategy applied to cigarettes in the 70's. (Owen B.J. Carter)

For example, in the U.S. it is estimated that poor diets contribute to 20% of medical costs which amounts to \$50 billion dollars (Harvard TH Chan, 2020) which could lead the government to impose increased taxation or penalties to companies contributing to the problem. The same reasoning was used during the master settlement agreement where, as mentioned before top tobacco companies had to pay more than \$206 billion in damages related to the cost of treating sick smokers. (B. Meier, 1998)

Another similarity in response from the 2 industries is denial. For example, Coca-Cola executive Katie Bayne said: "*There is no scientific evidence that connects sugary beverages*

to obesity.” (C. Morran, 2012) This is a typical public relations strategy that tobacco companies have used for several years before admitting their wrongdoing after the amount of evidence was impossible to reject to which they had to do a public “*mea culpa*” proposed by the justice department. (B. Kendall, 2011) It looks like companies selling unhealthy products are just getting out of this phase and are now trying to downplay the critics as well as creating healthier alternatives.

As per the laws being implemented, they especially aim at protecting children from such advertisements as they are labelled as “deceptive advertising”. (Amy M. Bernhardt, 2015) Indoor and outdoor advertising laws are being implemented for areas with schools within a specific radius (D Huang, 2020) (same exact initial approach to cigarette bans in the 70’s) Similarly to cigarettes, once companies get young people addicted to their products, they become lifelong customers and contribute to an ever-increasing growth for these companies which is why regulators are tackling the issue by starting where the problem stems from (children). (S. Milano, 2020)

One main similarity is the way companies are responding to the adverse publicity surrounding junk food and sugary drinks. Coca-Cola executive Katie Bayne said this: “*There is no scientific evidence that connects sugary beverages to obesity.*” This is exactly the response that was given by tobacco companies in the 1950’s and 1960’s.

Further down the line, another interesting comparison in response to the fact people were becoming aware that junk food and sugary drinks were bad: As mentioned before, in the 70’s, tobacco companies created a “light” cigarette and were fighting to see who could come up with the “healthiest” cigarette. Now, companies selling unhealthy foods and drinks are doing the same thing by “tricking” the public into feeling better about buying their unhealthy products. They do this by promoting the fact their products are “natural”, contain fiber, have low sugar etc. (see images below).

Picture G.3



Picture G.4



Picture G.5



This shows the “dynamic capabilities” of such companies to “mange” the response and perception of consumers. However, this is only a short-term solution because it doesn’t fix the actual problem and just camouflages it. The trick will be to do what PM did with the Iqos: offering a very similar experience with significantly reduces health risks.

The similarities between unhealthy food and tobacco go beyond the health effects. When it comes to corporate responsibility, executives at some of the nation’s largest food and beverage companies seem to have learned a lot from their counterparts at Big Tobacco by aggressively promoting consumption of their unhealthyproducts whilst blaming the consumer stating it is every individuals’ responsibility in the choices they make.

All in all, we can see that there are clear similar trends surrounding the fast-food industry which is following in the footsteps of the tobacco industry in terms of dealing with social pressure as well as increased regulation. Such companies can learn a lot from big tobacco companies and what happened to them by always being dynamically capable and staying a step ahead of any external disturbances in the market by changing their internal practices and vision.

9. Conclusion and takeaways:

We have seen how PM has managed disruptive change in their sector and still manages to be thriving even with all the efforts from government to restrict their practices. The constant adaptation, change in strategy and finally internal change of management have allowed tobacco companies such as PM to stay alive and continue to grow. Regulatory bodies will continue to attack such companies in the future, which is why they always need to be prepared for such events and prove their dynamic capabilities.

New Zealand just passed a law that aims to outlaw smokers born after 2008 forever from accessing tobacco products, even if they will be adults. This bold move may lead other countries to follow the same law which could be an even bigger risk for the industry. However, we have seen that they have always found ways to tackle such events. Tobacco companies are now masters at this since they have experienced regulatory adversities for many years which sets an example for other industries which are subject to increased regulation nowadays such as the liquor and food/drinks industry. Obvious similarities in response to change are to be noted.

The first main strategy is heavy investment in lobbying by trying to influence the regulatory landscape in their favor. The second strategy is constant denial at first, then acceptance and finally they implicate themselves in being part of a positive change (at least on the surface). Therefore, industries that are under constant regulatory threat should consider the adaptive strategies employed by PM, bolster their leadership team with a broad mix of management taken from industries, which have successfully managed the same regulatory disruption.

All in all, as mentioned by Jose Benikes (appendix H.2) companies will always try to build brands no matter if these brands are products that cause harm. However, given the current societal trends they can do so whilst minimizing the harm done to society and being profitable. If they do so correctly they will be showcasing their dynamic capabilities of constantly changing their vision, practices, workforce in an effort to accommodate the changes in markets driven by its consumers. The dynamic capabilities of these firms are what is ultimately going to lead to their survival and success in the future with a world that is changing faster than ever

before. PM has done so by not only responding and adjusting to environmental factors but most importantly are actively participating in it and shaping the industry of the future.

10. Appendices

Appendix A. Average number of ads in printed paper

Picture A.1

Table 1. Average Number of Cigarette Ads per Issue in *Time Magazine*, Selected Years 1929–84, Selected Issues

Years	Average No. Ads per Issue	% Increase From Preceding Period, as a Percentage
1929–52*	0.78	—
1953–63	1.54	+ 97.4
1964–70	2.14	+ 39.0
1971–73	4.72	+ 120.6
1974–81	8.28	+ 75.4
1982–84	5.28	- 36.2

(Times magazine, 2012)

Appendix B: Marlboro advertisements

picture B.1



(N. Patil, 2021)

Appendix C: Formula 1 promotion

picture C.1



(B. Grant-Braham, J.Britton, 2011)

Picture C.2



(P. Bolson, 2013)

Picture C.3



(Scuderia fans, 2019)

Appendix D: Iqos

Picture D.1



(G. Brasov, 2019)

Picture D.2



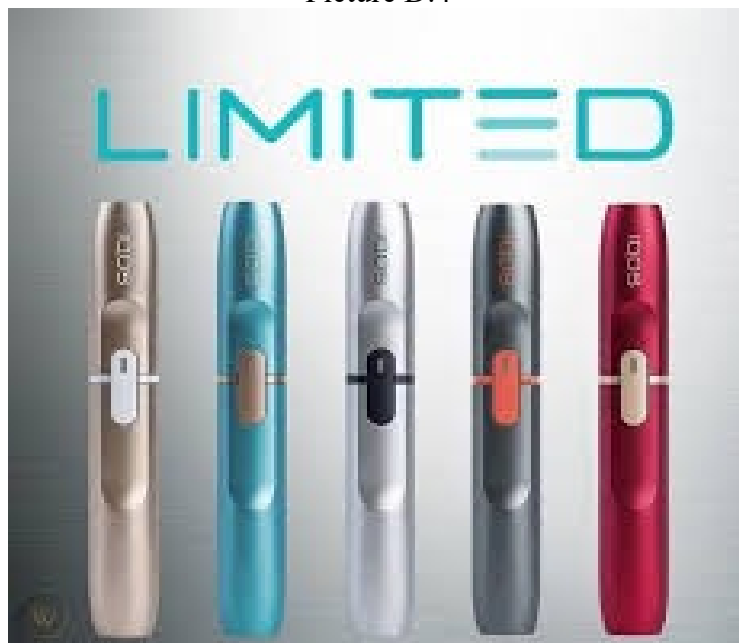
(Iqos website, 2018)

Picture D.3



(Iqos website, 2019)

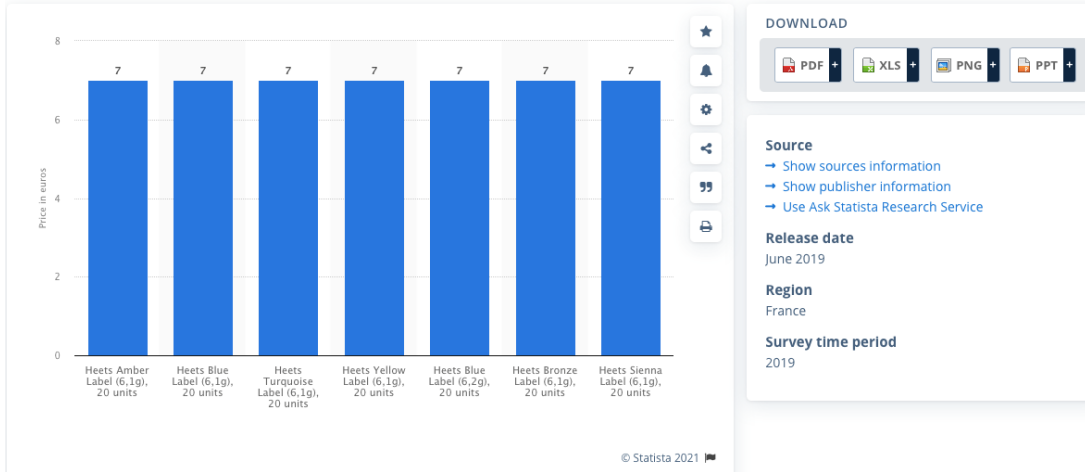
Picture D.4



(Iqos website, 2018)

Picture D.5

Selling price of tobacco sticks packs used with the IQOS smoking device of Phillip Morris in France in 2019, by product



(Statista, 2019)

Appendix E: Indonesian market

Picture E.1



(Putu Ayu Swandewi Astuti, et., al, 2020)

Appendix F: Bat Formula 1 advertising

Picture F.1



(BAT website, 2019)

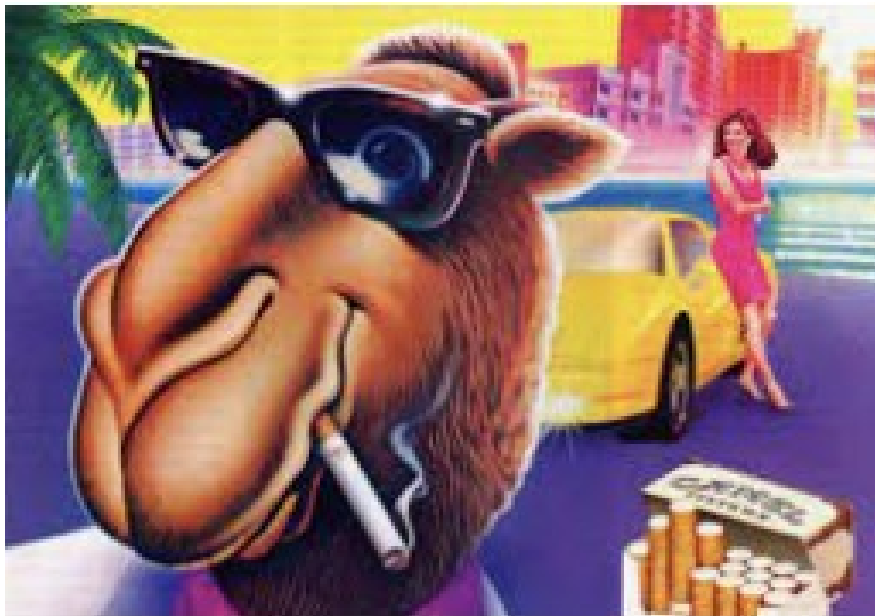
Appendix G: Print ads

Picture G.1



(A.Novakovic, 2015)

Picture G.2



(M. Burrows, 2013)

Picture G.3



(A. Bowles, 2014)

Picture G.4



(B. Rochmand, 2009)

Picture G.5



(T. Graeff, 2015)

Appendix H. Interviews

To gain a contemporary perspective on the Tobacco industry the following industry experts were interviewed in person or via email:

Mr Rui Minhos (see Appendix H.1)

Mr Jose Benikes (see Appendix H.2)

Mr Robin van Buuren (see Appendix H.3)

Mr Marco Ghiooto (see Appendix H.4)

Mr. Martijn van Buuren (see Appendix H.5)

H.1 Rui Minhos

Interview Date: October 2021

Job Title of interviewee: Director external affairs Portugal

Interview: face to face

Rui is a consultant working on projects for PMI – Portugal.

-There is no communication on IQOS from health authorities to the detriment of smokers that could benefit from it.

-Development of inhaler technology to ingest pharmaceutical drugs in a more efficient way.

-People don't stop smoking just once (about 7 times). These people that cannot stop smoking need to be given the opportunity to try reduced risk products.

-Rwanda example: People still cook with fire thus breathing in dangerous smoke making it not worth it to introduce iqos.

-Politicians are scared to be flexible with these new reduced risk products as they do not want to hurt their image and/or campaign.

-PM is leading the way for the industry with competitors usually mirroring their actions/strategy.

H.2 Jose Benikes

Interview Date: November 2021

Job Title of interviewee: General Manager & Head of Customer Engagement

Company: British American Tobacco (BAT)

Interview: Phone call and Emails

Jose worked at BAT from 1998 to 2018 in the Global Duty-Free department.

1st point on industry as a whole: If regulations become too strict and taxes become too big this will simply lead to the creation of a black market where cigarettes get sold illegally at a cheaper cost and without the appropriate health checks which ultimately acts to the detriment of smokers and goes against the initial goal of governments which is to improve people's health. Ultimately, the demand for tobacco will always exist which leaves governments with 2 options:

1. Ban cigarettes altogether which goes against freedom laws.

2. Adopt a comprehensive approach by working alongside companies to limit detrimental health effects of smoking. In countries such as Australia, big tobacco is seen as an evil which shouldn't be dealt with. Therefore they have banned all other forms of smoking such as heated tobacco or e-cigarettes. Although it may seem at first that they are trying to do good by banning addictive products it is actually counterproductive. Even though it is proven that next generation smoking devices severely decrease health risks. Therefore, preventing current smokers who wouldn't otherwise stop smoking from these next generation products is immoral and not good for society.

-2nd point differences in strategy between PM and BAT

An important point he mentioned is that although BAT is following the same strategy as PM to shift to next generation products as well as diversifying into different markets such as big pharma, it is not making bold statements like PM saying they will eventually stop selling traditional cigarettes. They basically want to minimize it but do not publicly say that they will stop selling cigarettes (which they know they won't). Jose's argument is that PM is using this as a brand enhancement strategy more than anything.

H.3 Robin van Buuren:

Interview Date: November 2021

Job Title of interviewee: Independent Consultant

Interview: Phone call and Emails

Robin worked for PM from 1993 to 2007 in senior finance and General Management roles. I asked him what he thought of PM's strategies and actions in response to disruptions in the market. He was exposed to this firsthand and was active during key periods of the changes facing the industry.

I think that the move to Iqos and the heat not burn technology was clearly driven by the legal landscape but also driven by the need to maintain market growth and continue to build shareholder value. PM has a long history of systematically increasing both share price and dividends over the past 60 years, and to do so has had to maintain solid growth of its underlying businesses.

Clearly the move to Heat not burn will enable the company to continue to grow in the new legal environment, but it may also be driven by other factors. Specifically, the competitive landscape and what growth was possible in the regular tobacco markets.

Acquisition Era:

If you look at the history of PM starting back in the 1950-60's they were mainly a USA brand and present principally in the USA, once they grew market share in the USA and had the leading position in the market it became increasingly difficult to increase volume and market share; going from 6% to 16% is way easier than from 50% to 60% .

1970 - 80"s EU expansion: With the USA market maturing and growth potential becoming limited, they looked to expand into Europe with the acquisition of their first factory outside of the USA in Neuchatel Switzerland, which is why to this day PMI has a factory and R&D centre there and the HQ is 75 Km away in Lausanne. During the 1970's and 80's PM grew rapidly in Europe and achieved market share in certain markets of over 50% through aggressive marketing of its Marlboro brand. During this period, they were relatively lucky as the competition in EU was fragmented and often were state run companies (e.g., SEITA - France , Tabacalera - Spain, ETI -Italy, etc). These state-owned companies tended to be sluggish and focused solely on their respective "home markets" In the late 1980's and 90's these companies started to merge and become increasingly more competitive and as PMI already had big market shares in Europe, they needed a new strategy to expand and maintain the growth momentum.

1980 -90's Diversification and Acquisition Era:

Essentially, they had 2 strategies that they followed in the late 80's and through the 90's:

1) They diversified into the food sectors both in Europe and USA, buying companies such as Kraft foods, Oscar Meyers, Toblerone, Cote D'or, etc... they leveraged their very strong balance sheet based on the tobacco side of the business to make important acquisitions. This I believe was partially in response to the increasing threats to their tobacco business which, as explained above, was facing better competition from BAT, Japan Tobacco, Reynolds - and the tightening of the legal landscape for tobacco.

2) In parallel, during the 90's the fall of the "iron curtain" gave PMI another solution of how to maintain momentum and continue to grow volume...namely the opening of the former Soviet Union and fall of the Communist countries of central and eastern Europe like Hungary, Czech Republic, Poland etc. This opened a massive new market and through direct acquisitions PMI bought numerous national tobacco companies, such as in Poland, Czech Rep, Lithuania, Hungary, and Kazakhstan and also opened their own factories in Russia. This was a focused strategy of growth through acquisition, which they also pursued in Asia with the acquisition of Sampoerna in Indonesia and the merger with La Suerte in the Philippines. The strategy of growth through acquisition also occurred in Europe with the acquisition of Tabaqueira, Portugal, in 1997.

Post Acquisition Era:

By the 2000's the growth of the regular tobacco industry was being threatened by legislation, significant tax increases and greater awareness of the dangers of tobacco to health that contributed to a continuous decline in consumption of tobacco, especially in the profitable and high margin businesses in the developed world markets, notably Europe. Equally, the growing legal restrictions in Europe and other EU wide legislations, was seriously impacting its ability to market and grow volumes.

For many years PM followed the letter of the law, if not the spirit of the laws. As explained before, during the 1990's PM Europe made a significant switch from Above the line advertising as imposed by law to below the line advertising and marketing strategies. These strategies included the massive investment into Formula 1 , GP racing, Rally car and sailing sponsorship deals, which enabled the company to maintain the brand images and values in the public eye on a global and national level. Equally, they developed so called "Alibi advertising" strategies creating the Marlboro Classic clothing brand, launching music events such as "Chesterfield nights., they developed aggressive point of sale communications, and increased trade promotions. However even these

strategies eventually had to be cancelled due to tightening legislation and a backlash from the anti-tobacco lobby and media.

Around the period of 2005 to 2010, senior management saw only two opportunities for significant future growth. Namely. 1) Entry into the largest cigarette market in the world – China or 2) A new direction with next generation tobacco products.

1) China is the single largest market for tobacco. More than half of all adult men are tobacco smokers. About one in every three cigarettes smoked in the world is smoked in China. (World Health Organisation).

“The China National Tobacco Corporation (CNTC) controls 44 percent of the global cigarette market, making it the biggest cigarette company worldwide. PMI came in second place with 14 percent of the total market” (Jan Conway, 2019)

As per the above statistics If PM could gain a meaningful market share in China this could be a strategy for future growth. PM made many attempts to break into this massive and lucrative market but has failed. The market is centrally controlled by the China National Tobacco Corp. (CNTC) with significant barriers to entry by foreign entities.

“In December 2005, PMI signed landmark strategic cooperation agreements with the China National Tobacco Company for the licensed production of PMI’s Marlboro brand in China, and for the establishment of an international joint venture to promote Chinese heritage brands in international markets”. (PMI website, 2021)

However, to this day the PMI market share in China is insignificant. Therefore, the only realistic alternative was to focus on the "free open" markets i.e., outside of China, and with a strategy and product that would fit within the new legal and health expectations of consumers i.e., the switch to the next generation

tobacco products and specifically the "Heat not burn" technologies that the company developed..

H.4. Marco Ghiotto:

Interview Date: November 2021

Job Title of interviewee: Vice President Consumer and Trade Marketing

Company: Japan Tobacco International (JTI)

Interview: Phone call and Emails

Marco has over twenty-five years' experience in the tobacco industry working for PMI and JTI.

- Marco mentioned that one of the main reasons for the "master settlement agreement" (where the top companies had to pay \$206 billion dollars in damages to the health cost incurred by smoking) was not entirely because of health risk but also because governments needed money to fund costly war efforts for example. Therefore, big tobacco companies were a good target for them because they had a lot of money, and the government had a legitimate reason (health) to attack them.

-He also mentioned that the response of PM to all the penalties and restrictions was arrogant at first. At the time they were always trying to fight back and not admitting that their products were dangerous. This then changed in 1994 with a change of management where PM started to accept responsibility and being pro-active in the legislative landscape by investing heavily in lobbying.

-This is where Marco also introduced another interesting point: Companies such as P&G which have nothing to do with the cigarette industry were copying the PM model of being pro-active in the legislative landscape and investing in lobbying because some of their products also cause health issues.

Now moving forward in time: Marco also mentioned that in 2016 the top companies at the time (PM, JTI, BAT) were working alongside the government to push to further regulate e-liquids for e-cigarettes. This meant start-ups would have to spend millions of dollars just to launch their liquids. This had a double purpose: Firstly, it would demonstrate to regulatory authorities their goodwill of making sure they were selling products that would be the least harmful to consumers as well as creating a strong barrier to entry for start-ups and small companies. With this they managed to swipe 95% of the market creating an oligopoly.

When Marco was working for JTI at the time and the "EU tobacco advertising directive" was implemented in 2005, JTI was forced from the Japanese government to pull out from sponsoring the Formula 1 whilst PM and BAT stayed. Therefore, he mentioned that one the only communication channel left today is POS advertising.

From a competitive standpoint Marco mentioned that the future of JTI doesn't look very good in comparison to PM and BAT. The reason for this he says is that JTI talk a lot about different strategies and moving into different markets but never actually take the risk to do so because management and top executives to not want to take the blame if something goes wrong.

H.5 Martijn van Buuren

Interview Date: November 2021

Job Title of interviewee: Sales Director – Pinkster Gin (UK)

Career: Diageo Plc. head of UK Sales up to 2014

Interview: Phone call and Emails

Martijn has over 30 years' experience in the alcohol and drinks industry at senior leadership roles.

Do you see a similar set of laws/bans being implemented on alcohol compared to tobacco in the past/present/future (advertising, alcohol % limits...)?

No – in the UK advertising still permitted – the thing is that where alcohol differs from tobacco is that alcohol is accepted as part of social behaviour and the drinks companies & trade bodies continually point out to government that by far the greatest proportion of society use alcohol responsibly. There is a recognised small minority where alcohol is abused.

2. What main event (legal, social...) shifted marketing practices for the alcohol industry? Did it have any negative consequences?

Responsible drinking was the main communications shift with product choices that included 0.00% and low alcohol drinks. There was also in the UK strong collaboration with government on what constitutes acceptable consumption. Units of alcohol / week were given as guidelines for male/ female drinkers, backed up by the medical profession.

3. What did Diageo or other alcohol companies do to tackle such restrictions on advertising etc... and what other ways did they market their products? (Maybe sports sponsoring, events marketing, or other "below the line" marketing strategies?)

Diageo and other big drinks companies like Heineken used sponsorship wisely and made sure their drinks portfolios had credible Lo/No abv options along with their favourite drinks – all about consumer choice.

4. What is their most likely strategy in the future?

Close work with the key trade bodies, Drinks companies' corporate governance teams and government are the strategies employed today to stay close and 'be in the conversation' with government decision makers. Examples of this are the sponsored initiatives that drinks companies undertake to demonstrate real skin

in the game e.g.: Soho Angels sponsored by Smirnoff to promote late night safety in targeted areas.

5. Is the legislative landscape being more/less restrictive in the future ?

Not sure about this. I think there will be a slow burn escalation of restrictions on types of alcohol – especially the strong products like Kestrel Super Strength at 9% – was the preferred poison of alcohol abusers – these will be reduced or restricted on distribution. What I think will happen is that drinks companies will be led by consumers and their tastes which indicates a rapidly growing appetite for 0.0 products like Heineken 0.0 / Guinness 0.0 / Sedlip which over time will become their ‘big’ brands of the future – see the Spanish 0.0 category growth in the past and current millennials trends.

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