

Tobacco Strategy Review Team

The tenth meeting of the Tobacco Strategy Review Team was held on 31st October 1988.

Present: Mr. P. Shaehy, Mr. E.A.A. Bruell, Mr. J.D. Bramley,  
Mr. R.J. Pritchard, Mr. U. Herter, Mr. L.J. Saboia e Silva,  
Dr. R. Salter (Secretary)

Mr. B.P. Garraway, Mr. H.F. Frigon, Dr. H. Erichsen and  
Mr. P.J. Rombaut also attended the meeting.

Mr. A.L. Heard was present for items 11 to 25 inclusive.

1. Introducing the meeting, the Chairman said that the membership of the team had been extended to include the Chief Executives of the Tobacco businesses in BATCo., BATUS, BATIG and Souza Cruz with Mr. Bruell representing the Associated Companies, Imasco and Amatil.
2. Reviewing the terms of reference, it was noted that the principal aims of the team would be to ensure that the Group mounts a coherent strategic thrust in Tobacco, that there is effective technical and marketing co-operation between the Group's Tobacco businesses and that there is a unified approach on Smoking Issues.

The team would be concerned with major new initiatives and with removing structural and other obstacles to effective marketing or technical co-operation. It was not intended that it should be concerned with monitoring progress in areas where co-operation is already proceeding satisfactorily or with issues which are specific to only one Operating Group. However, it may be used as a means for sharing information in cases where this appears to be appropriate (e.g. where a development in one company could be of wider interest).

3. The minutes of the previous meeting, held on 5th November 1987, were agreed.
4. On Smoking Issues, Mr. Bramley reported that the summary compendium would be completed in November and it is hoped to be able to launch it by the end of the year.
5. Following on from this, it is hoped to be able to complete and launch a more detailed compendium, which will be directed at the scientific community, in March 1989.
6. It was noted that the major public conference on low-risk epidemiology, covering a range of other subjects as well as Tobacco, was still scheduled to be held in Germany in March 1989. Philip Morris were organising their own conference in February but this would be limited to Tobacco. It was unfortunate that the two conferences were being held so close together and Mr. Bramley was monitoring the situation to ensure that any possible adverse effects were minimised.
7. The Chairman emphasised the importance of maintaining pressure on Smoking Issues. He believed that the two compendiums would be useful in this respect and stressed the need to have them translated into German, Spanish and Portuguese.

It was suggested that while maintaining pressure at the national level, particular emphasis should be given to organising representations at municipal level, using local people as much as possible.

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8. It was noted that work sponsored by the Tobacco industry in the USA on Environmental Tobacco Smoke (ETS) was being funded jointly by Philip Morris and R.J. Reynolds rather than by the Tobacco Institute. Brown & Williamson had put money into privately funded projects at the University of Kentucky and was active in promoting work on 'sick-buildings' to research the degree to which radon and air conditioning systems were important contributors to environmental health hazards.
9. Mr. Hartar reported that BATCF had organised a conference on ETS jointly with the Austrian Tobacco monopoly. They were also co-operating with wholesalers in ensuring that the industry position was represented effectively to government both at local and national level.
10. Mr. Sabola reported that Souza Cruz were also active in this respect in Brazil where there was a trend towards more restrictive legislation (e.g. regarding ETS in non-ventilated enclosed spaces).
11. Mr. Heard reviewed Research and Development. Total Group expenditure on Tobacco-related R&D was £30 million. The majority of this was managed and funded locally but there was a co-ordinated programme of Group Strategic R&D accounting for around 10% of total expenditure. Total expenditure in 1988 had been budgetted at £3.3 million split as follows:-

(a) Smoking Issues Research (External)	£0.3 million
(b) Fundamental Research (mainly BATUK&E)	£2.0 million
(c) Project Greendot (BATUK&E)	£0.5 million
(d) Project Airbus (Brown & Williamson)	£0.5 million
12. Smoking Issues Research comprises a group of projects by medical and other scientific departments of universities, by hospitals and by other reputable institutions identified and agreed with CAC companies. The cost of these projects is split equally between the CAC companies, excluding Brazil. It was noted that the same system of funding would be retained in 1989 but that the overall level of expenditure would be increased by 10%. This was a lower level than the original proposal, which had been for an increase of 25%.
13. It was noted that the Fundamental Research programme divides into projects responding to regulatory issues (such as Environmental Tobacco Smoke) and those aimed at improvement of product quality. Important elements of this work are projects to reduce specific products from smoking to defined levels, projects to measure the degree to which certain chemicals persist in enclosed environments and the development of in-vitro tests applicable to tobacco products. Consideration is given to publishing work wherever this is judged to have scientific merit. Product developments include a fire-safe cigarette and flavour developments in Souza Cruz. It was noted that a 15% increase in expenditure on fundamental research to £2.3 million was proposed for 1989.
14. Project Greendot has the specific aim of developing a cigarette with very low tar content but normal nicotine delivery. The aim is to move from a current 10:1 to a 2:1 Tar/Nicotine ratio over a five year programme of development which will include modifications both to the Tobacco and to the design of the cigarette itself. It was agreed that in view of the importance of this project, efforts should be made to accelerate the development programme. The proposed level of expenditure in 1989 is £0.75 million, which is a 50% increase on 1988.

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15. Project Airbus is a more radical approach to develop a product which has some similarities to the recently launched RJR Premier, but which relies on an alternative system based on developments by Ellis and Hughes, patented by BAT.
16. It was noted that RJR had now launched Premier in two States in the USA. While it was too early to be able to gauge the response of the market, the initially unattractive taste and aroma and the technical problems associated with the difficulties in lighting the product, the variations in length and a shelf life limited to five months were all identified as significant problems that would need to be overcome. It was also noted that even the status of Premier as a fire-safe product depended on a narrow technical definition of the test applied and was critically dependent on the orientation of the product when tested.
17. In addition, there is the more fundamental and still unresolved question as to whether the product will be classified as a drug delivery system rather than a cigarette and thereby fall under the jurisdiction of the FDA.
18. Despite the uncertainties about Premier, it was agreed that this was a significant development in which there was a high level of public interest and which could not be ignored. It was also noted that although Philip Morris had not made any public statements on the RJR development, they were thought to have developed a similar product which they were holding in reserve for a possible launch as a competitor to Premier.
19. With the exception of Switzerland, where new regulations would effectively preclude the launch of this type of product, most countries were adopting a similar attitude to that in the US in taking at least a neutral stance. No restrictions were expected on sales of the product in Brazil and in Germany, the authorities were generally supportive of a development which was seen as being positive on public health grounds. However, it was still thought that if there was a decision in the US that the product should be classified as a drug delivery system, attitudes would be reversed worldwide and RJR themselves have said that if the product were to be placed under the jurisdiction of the FDA, it would be withdrawn.
20. It was agreed that pending clarification of the regulatory situation and further evaluation of the impact in the market of the RJR product, the development of Airbus should continue.
21. It was noted that since the design of the product involves some combustion of the Tobacco, it has a greater claim than Premier to be classified as a genuine cigarette. However, it might still encounter the same difficulties as Premier if this was classified as a drug delivery system.
22. It was also noted that there were still technical difficulties to be overcome and it had not yet been possible to develop a prototype of a satisfactory Airbus product. The current aim was to complete this phase of the project by March 1989.
23. It was noted that it was proposed to increase the expenditure on the project from £0.5 million in 1988 to £3.88 million in 1989. However, in view of the uncertainties both about Airbus and about Premier, it was agreed that before going beyond the prototype stage, the project should be reviewed again in the light of the progress achieved in the project itself and in relation to the situation with regard to the RJR product. It was agreed that this review should be held in March 1989.

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24. It was suggested that the expenditure on the Fundamental Research, on Greendot and on Airbus should be funded on a similar formula to that applied in 1988 giving allocations as follows:-

<u>£m</u>	<u>1988</u>	<u>1989</u>
BATCo.	0.75	1.73
Brown & Williamson	0.90	2.08
BATCF	0.57	1.32
ITL	0.57	1.32
Amatil	0.21	0.48
TOTAL	<u>3.00</u>	<u>6.93(a)</u>

Note (a) £3.38 million of the additional expenditure is accounted for by Airbus and is subject to a favourable review of that project in March 1989.

25. On Tobacco Expansion:-

- (a) Mr. Bramley reported that the APEX development is held up pending the completion of toxicity tests where there have been problems in finding suitable laboratories who have the capacity available to undertake this work. The costs of installing the plant are also being queried. However, this is still considered to be an excellent product.
- (b) It is intended to close the DIET plant in Berlin and to sell this to Australia.
- (c) It was noted that G13 is still in use in Singapore and the Chairman underlined the need to implement the policy to eliminate processes using Fluorocarbons throughout the Group.

26. On Leaf Buying, Mr. Bramley reported that the co-ordination between BATCF and BATCo. was progressing and would be fully operative by end-1989. More generally, it was noted that greater co-ordination of leaf buying would enable stocks to be reduced throughout the Group and it was asked that Mr. Bramley should arrange for Mr. Davis to produce a review report for the next meeting, showing the impact of co-ordinated leaf buying in reducing durations.

27. Reviewing the progress with Barclay and Capri, it was noted that:-

- (a) Capri was now national in the USA where it had an 0.45% market share. The 120mm product had been launched and the Chairman suggested that this version was a particularly clear statement of what the product stood for.
- (b) Elsewhere, Capri had been launched in 68 markets and while the progress of this product and of the competitive product Vogue had been limited in Europe it had made more progress in the Middle East.
- (c) Mr. Herter reported that there was no real interest in Ultra-thin products in Germany and Barclay was still having limited success. However, the brand was being maintained and further attempts would be made to develop it in 1989.
- (d) Mr. Bramley reported that Barclay was still progressive in Holland, Belgium and Finland and was holding share in Switzerland. However, there was no interest in Denmark.

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- (e) Mr. Pritchard reported that despite the attacks by Philip Morris, Barclay was still doing well in the Middle East and was progressive in other export markets.
- (f) Although Callahers had shown no interest in licencing Barclay or Capri, Tabacalera had shown a more positive interest and further talks on this were scheduled for November. It was also intended to negotiate with the Swedish monopoly in 1989.

The Chairman reiterated the importance of keeping up the pressure in developing the markets for Barclay and Capri and asked for a further review of progress to be prepared for the next meeting of the team.

- 28. Regarding the work to prepare for the Single European Market scheduled for completion by 1992, the paper summarising the current position on the project to push ahead with Manufacturing Rationalisation was noted.
- 29. Mr. Bramley reported that Mr. Heywood was chairing a team, including representatives from BATCF, which had set up study groups to prepare proposals on each of the key aspects of the Group's activities which were likely to be affected by the development of the single market.
- 30. On Tax Harmonisation, BAT were trying to persuade the Commission to move from their current proposal of a specific tax of 19.5 ecu and an ad valorem tax of 52% to 31.7 ecu plus 40% ad valorem. This was felt to be more realistic than the position adopted by the other Free Enterprise Tobacco companies which were still pursuing a policy of pressing for a 100% specific tax, in direct opposition to the Monopolies who were pressing for 100% ad valorem.
- 31. The study group were also considering the problem of Roll Your Own (RYO) and were formulating appropriate proposals.
- 32. The Chairman emphasised the importance of coming to a firm decision on the optimum BAT position on the tax issues including RYO, as a preliminary to pursuing this as effectively as possible on a political rather than merely a technical plane. He also suggested that further emphasis should be given to strengthening the political approaches being made both to the Commission and to individual Monopolies and Companies in an attempt to influence them towards our point of view.
- 33. Mr. Bramley reported that a position paper was being prepared on marketing issues arising from the single market and this would be completed by the end of the year. This, and the other aspects of the European Single Market, including the effect on the Duty Free trade, were continuing to be given a high priority within BATCo.
- 34. Following a discussion of Cigarette Exports, it was agreed that a separate study should be set up to review the criteria applied by each of the Tobacco companies in deciding both the extent to which exports should be pursued and the way in which each market should be sourced. In the latter case, one of the factors to be considered would be the need to ensure that the activity provided an acceptable return on the funds employed in the business, taking both fixed assets and working capital into account.

Subsequent to the meeting, it was agreed that Mr. Pritchard would be responsible for co-ordinating this study.

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35. It was noted that in certain markets, competitors were offering cigarettes at very low prices, thought to be sourced from Brazil. The Chairman thought that this might be classified as dumping. He asked the Secretary to investigate further whether this is so and, if it is, what action might be taken against the companies concerned.
36. On the development of new markets and the co-ordination of major initiatives to improve market share (e.g. in Japan, China, Thailand, Turkey, etc.), it was agreed to defer discussion until the next meeting.
37. Regarding Skandinavisk, it was noted that no further action was possible at present to increase the Group's shareholding in the company.
38. Regarding representation in Italy, Mr. Bruell and Mr. Fritchard reported that after reviewing the position they had decided that there was no real alternative to continuing with the current agent. However, there would be continuing efforts to find ways to improve the effectiveness of this representation.
39. On Management Development, the Chairman emphasised the need for the managers in the Tobacco business both to take an active interest in the Tobacco courses at Chelwood and to suggest improvements where these were felt to be appropriate. One of the advantages of having industry specific courses was that they provided an opportunity to cover subjects which were important to the industry and which managers ought to know about as part of the general background to their jobs. As an example of this, everyone should be informed about excise systems and their importance to Tobacco companies. If Chelwood did not include this as a subject on their Tobacco courses, it should be suggested to them that they should.
40. Inter-company transfers of managers were an important aspect of management development and it was suggested that progress on this should be actively monitored by the team. Subsequent to the meeting, Mr. Branley was asked to co-ordinate this and to report back on the arrangements which had been set up.
41. The current developments at RJR/Nabisco were noted and it was agreed that the information on the current status of their overseas Tobacco operations should be updated so that BAT could move quickly if opportunities or threats emerged as a result of changes in direction by RJR. Mr. Bruell agreed to co-ordinate the collection of this information on the current market position, the physical facilities and the estimated values of RJR's overseas operations. It is intended that this review will be completed by the end of November when it will be discussed by the CPC.
42. It was noted that the next meeting of the team is likely to be held in 6 months' time in March/April 1989.

RS/DJA  
23rd November 1988

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