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A meeting to discuss Project Stem was held on Thursday 9th September 1993 in Windsor House.

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Present: Mr M F Broughton, Mr U G V Herter, Mr D P Allvey, Mr B D Bramley, Mr N G Brookes, Mr A Monteiro de Castro, Mr B Levitt, Mr T E Sandefur, Dr B Schweitzer, Miss H C Barton (Secretary)

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**Mr Broughton's Introduction**

1. Mr Broughton introduced the meeting by saying that he had no pre-conceived ideas about the outcome. Most structures can be made to work with commitment, and no structure can work without commitment, therefore he is looking for maximum commitment. A decision is unlikely to be reached today as he will wish to reflect on what he observes and hears. Nevertheless a decision will come out of the discussion today.
2. As background, Mr Broughton took extracts from the Group Strategy Review to show the strategies which are already agreed. As a result of this meeting we must either agree to implement these agreed strategies or make proposals to the Board to change strategy. The most relevant statements were from "organising for competitive advantage": balance between co-ordination and decentralisation; regional strategy; and manufacturing location strategy. As a result of the discussions between Miss Barton and each TSG member, and at the CEC, the following list of issues had been developed for discussion during the day: culture of decentralisation; end market control; "zones of influence"; brand owner concept; sourcing and capacity planning; management information; and performance measurement and motivation.

**Mr Herter's Proposals**

3. Mr Herter set out his ideas on organisation as an outline for the discussion. The three current principles of organisation are: Operating Group; the brand owner; and the TSG for strategy, central co-ordination and conflict solving.
4. There is clear responsibility for markets, and no conflict or duplication of effort, in US, Germany, Brazil and Canada and where there are BATCo operating companies. There is conflict and duplication of effort in export markets. There is least conflict in Japan, South Korea, Italy, China and Taiwan. Despite the conflict (or because of it?) BAT has been successful, but less so than PM. PM is more centralised, therefore it is valid to ask whether BAT would have done better if it had been more centralised. Mr Herter believes we would not have done better in US, Canada or Brazil. We may have done better in Germany because we concentrated there on domestic brands for too long, and similarly in some BATCo operations. However he believes this is less a structural problem and more a management problem, and is being resolved.

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5. Mr Herter believes we should plan to build on our strengths and to overcome our weaknesses. This means tackling the export markets, treating them as domestic markets and avoiding the duplication of effort. We have been discussing it for years. The environment has changed and a solution is overdue. Each export market must be managed as a domestic market with a single management. If we stay with the Operating Group structure we must decide which one is responsible for each market. The market manager is then responsible to the Group as a whole and not just to his Operating Group. He must select the appropriate brands from the total Group portfolio, and therefore he needs to know the Group profitability of the market.
6. Mr Herter believes we must stay with the brand owner concept rather than having a central Marketing Director. The brand owner should be responsible for concept development (i.e., communication), and the product and pricing strategies. This does not mean telling the other operating groups what to do as this kills creativity. One strength of decentralisation is that we can use the creativity in Marketing around the globe. This should be channelled by the brand owner discussing his strategy and plans with the other Marketing Directors. Only disagreements need the intervention of the TSG. To set priorities between brands, we will also need to know the profitability of the brands. There should be a full day discussion of the IBs at the TSG each September, where the brand owner would present his strategy for the next year.
7. The CEC sees individual operating group capital expenditure plans and proposals but no overall group view. Mr Herter proposed that the four production directors should be asked to put a group view to the TSG on capacity planning and product sourcing.
8. Mr Herter does not believe that we should adopt an extreme solution as we would lose many of our strengths, not resolve our weaknesses and maximise disruption.
9. Mr Broughton opened the general discussion by saying that he believed there was general agreement on end market control but it was not clear to him that everyone meant the same thing by the same words.

#### TSG Members' Opening Statements

10. Dr Schweitzer believed that we should take account of our culture and history. We have strong local brands which are developing into regional brands and we should therefore move to a regional organisation. The brand owner's prime responsibility is to develop brands, and therefore "brand developer" would be a better term, to avoid the impression that he has total control over the brand. He supported the development by Lucky Strike into an International Brand but did not believe that we yet have the right product or communication. An IB is defined by how the consumer perceives the name and the pack.
11. Mr Sandefur agreed that each market should be managed as a domestic market. It is his basic belief that any company will fail with lack of goodwill and mutual respect. Any organisation can be improved but structure is no guarantee of success. For example, RJR has an almost identical structure to that of PM but it is less successful. Both work with USIBs and lack UKIBs. PM manages Marlboro centrally and RJR manages Camel centrally. Historically PM had a stable management team with mutual respect and consumer focus. RJR lost its way in the 1970s as a result of a competition for CEO succession, leading to internal focus, "turf warfare" and the eye being taken off the business.

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12. Mr Sandefur saw the main advantages of BAT being a better brand portfolio, a truly global company, "alarmingly pleasant" with far more local autonomy and faster decisions. The main weakness is the lack of well defined accountability leading to misunderstandings, turf wars, talk being about people rather than about competitive problems, and mistrust.
13. Mr Castro believed we should capitalise on our decentralisation strengths and that we should balance the importance of IBs relative to regional and local brands. His main concern was the conflict in export markets. The right brands for each market should be chosen ignoring product sourcing and the brands that happen to be owned by the Operating Group. This leads him to a decentralised model on a regional basis. The concept of annual brand owner presentations to the TSG can also be used within the regions. The regions should report to one person, a regional leader, who is not necessarily part of an Operating Group. It would be necessary to know the profitability of each market, even if there is some double-counting of profits in the management accounts between sales and manufacturing organisations.
14. Mr Bramley pointed out that PM is centralised only for Marlboro. He thought that there was agreement on decentralisation but we need to agree what should be centralised and why. He believed we should centralise those things which give us competitive advantage, for example, brand management and trade marketing. The Operating Group structure was established because the Group was diversifying and they were going to be national holding companies. Now that we are concentrating on tobacco again, we should question whether it is still the right structure.
15. The roles of B.A.T Industries and the TSG should also be questioned. Mr Bramley believed that the tobacco business should be structured as if it were a free-standing company. The TSO should be the tobacco board with more accountability. It should know the profitability and cash flow of markets. There should be central co-ordination of Marketing, R&D, Leaf and Trademarks. Mr Herter would then be surrounded by people with tobacco expertise, and be in constant contact with the market and the issues, and not risk being isolated.

#### Marketing

16. Mr Herter commented that a central Marketing Director would be responsible for about seven IBs while responsibility for the other brands would remain in the Operating Groups, and that this would be another source of conflict. Instead of having one Marketing Director, he would prefer to continue with four, each responsible for IBs and domestic brands.
17. Based on personal experience, Mr Sandefur said that the job of central marketing officer is extremely difficult as it depends on receiving the information to assess the needs of each local market. It would be better for the TSG to agree the policy and strategy and leave detailed decisions in the market where the knowledge is.
18. Mr Herter believed that, while it is not concerned with operations in any particular country, the TSG is adding the additional role of becoming a management and decision-making body concerned with high level questions of co-ordination and strategy. This implies that it needs to meet more often. The previous IB planning meetings did not work because they did not make decisions.

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**Production**

19. Mr Broughton saw a distinction between Marketing and Production. Marketing is the business we are in and the number ones are responsible for their markets. Therefore a Marketing Director's role would be difficult and it would probably be better to have co-ordination between the four Marketing Directors at a TSG or Tobacco board meeting more frequently. The position with respect to Production is less clear. Some factories are specifically local but for those with a high proportion of exports we need the ability to change source, standardise and rationalise.
20. Mr Broughton asked, if the region is accountable for sales and marketing within some confines, and is credited with the total group profit on its sales, where is the responsibility for the factories?
21. Mr Bramley believed that if a factory manufactures for the domestic market it should report to the number one in the market. If not it should report centrally, either to a Production Director, or (as in BATCo) to a Marketing Director. It is a problem if one company reduces its sales forecast causing a factory in another company to make less profit. BATCo is trying to develop alternative measures for the factory management.
22. Mr Herter believed that the day-to-day factory management should report to the market management but capacity planning should be centralised.
23. Mr Bramley observed that manufacturing projects from the TSG are given to a variety of people. He believed one individual should be responsible for manufacturing strategy, including capacity planning, modernisation of plans, machinery, pack sizes and purchasing.

**Regions / "Zones"**

24. Mr Castro did not think that the regional co-ordinators should be in London. If the regional leader was also the GM of one company in the region, this would eliminate a layer.
25. Based on his experience, Mr Broughton believed that it would be very difficult to combine both roles and would lead to conflict.
26. Mr Bramley believed that the merit of team work in the centre between the regional leaders and the service advisers outweighed the disadvantages of not basing the regional leaders in their regions. It also cuts out a layer of management and is less likely to lead to duplication between the centre and the regions.
27. The definition of regions was discussed. Mr Levitt explained that the different businesses within Imasco have different regions, with decisions made at the level which gives a competitive advantage. In general, countries matter less than they once did. Markets can be less than whole countries or more than one country.
28. Mr Bramley believed that we need different types of managers for different regions, for example, in the Far East as opposed to in Africa. An attempt was made in Project Rubicon to design regions so that some modifications could be made, for example, to which region the Middle East was in, without affecting the RBU structure. If strong regions reported to a B.A.T Industries tobacco division, there would be no need for BATCo.

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29. Mr Broughton thought that the most difficult regions to define were Europe and the Far East. There are two "Europes" with Germany in both the EC and in eastern and central Europe, but very little in common between the two extremes. Japan is in the Far East, but its market is so Americanised that it makes sense for B&W to remain responsible for it. It was generally agreed that it made sense for B&W to continue to be responsible for Japan, Korea and the Philippines.
30. A map of the world was discussed which showed a possible allocation of markets to Operating Groups. Mr Herter explained that it builds on the Operating Groups, towards possible regions for the future, without changing everything all at once.
31. Mr Broughton asked whether we should move straight to a region called Europe or evolve towards that by initially giving BATCF responsibility for the Eastern European markets. Dr Schweitzer, Mr Castro and Mr Bramley thought we should move straight to a European region with a regional leader either in the UK or on the continent. Mr Herter thought we should develop towards that by giving to BATCF and to BATCo the responsibility for the markets about which they have the best knowledge.
32. Mr Castro was concerned about the psychological effect on Souza Cruz of being allocated only Cuba where they have no business. Mr Bramley agreed that, if we were not to move immediately to a Latin American region, it would be better to select some Mercosur markets and allocate them to Souza Cruz. In the medium term it should not matter to Souza Cruz whether it is responsible for other markets or not, since if the system works as intended, there will be good export demand for Souza Cruz products. However in the interim, since this is not the way things have worked in the past, it would be better to allocate some markets in order not to demotivate the management team.

#### Role of B.A.T Industries

33. Mr Allvey believed that B.A.T Industries, with more than one business, gave a higher return to shareholders than the businesses would demerged.
34. Mr Bramley thought that many of the functions in B.A.T Industries should be delegated, for example: Technology Review; Environment Review; Training; Trademarks. Much of this work is co-ordinated for, but not really owned by, the tobacco business.
35. Mr Broughton stated that many of the reviews were group reviews, but it would be better if timetables allowed them to go to the TSG before they went to the Group Board.

#### Motivation

36. Mr Levitt believed that people tend to do what they are motivated to do, and therefore incentives should include a mix of company and regional factors. An attempt should be made to tailor the factors to the elements that the manager could control or influence and that there should be a heavier weighting to regional and group factors for the more senior managers.
37. Mr Sandefur believed that senior managers in the group's "centres of excellence" are motivated by their belief and involvement in BAT.

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**Management Information**

38. Mr Broughton said that we had moved too far to managing the group by legal entity and therefore the CEC did not receive certain useful management information. This is tied in with the remuneration of the Boards based on Operating Group profit. Brand profitability and cash flow is needed to add to market and then regional profitability. The market manager should be credited with the group profit on a brand whether he manufactures the product or not. Brand profitability will also be available at the centre, with the Tobacco management board having to manage the matrix.
39. Mr Allvey pointed out that the statutory accounts would differ from the management accounts for tax and borrowings reasons but the two must be reconciled. Care will also be needed in countries where we have a minority shareholding to which the local manager also has a responsibility.

**Use of the BAT name**

40. It was agreed that changing company names to include BAT should be considered on a case by case basis, and that new companies should take the BAT name. Dr Schweitzer said that the British-American Tobacco name would be useful on his packs as it would give a good message to the consumer. Mr Castro thought it would be good to have the British-American Tobacco name on all packs of Lucky Strike and Kent. Mr Herter thought that we could benefit from the quality of the name as advertising restrictions make it more difficult to communicate. Mr Sandefur said that he would be happy to use the name in the US. It was agreed that the use of the name would not be dictated but maximum use should be made of it.

**Conclusions**

41. Mr Broughton summarised the areas of agreement as:
- a) Decentralisation is part of the group's culture and one of our strengths. We should continue to push authority down to the most appropriate level.
  - b) There is a need for improved accountability on an end market basis.
  - c) Different management information is required with the market manager being credited with and incentivised by the group profit on the brands sold in his market.
  - d) The brand owner concept remains valid, although more as a brand developer, with responsibility for concept, product, pricing and communication.
  - e) There is not a convincing case for a centralised marketing function.
  - f) There is a case for a centralised role covering product sourcing, capacity planning and perhaps R&D. This is not the same as a Group Production Director.
  - g) A regional structure is likely to evolve although there is some disagreement about the basis and how quickly we should get there. The term "zones of influence" is more appropriate than "regions". In the interim we should continue to use the four management teams that we already have to manage the evolving structure.

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- h) The TSG should evolve more towards a Tobacco Management Board.

#### Implementation

42. It would be ideal to budget, and to agree Directors' Incentives, on the new basis. In practice we will not have the management information in time. We could either budget on an estimated basis or wait for better management information and then switch. There was a general desire to press ahead and implement from the 1st January 1994, but it was recognised that this would not be possible in some of the more difficult markets (for example, eastern Europe).
43. Mr Herter proposed that we could announce a change now for implementation in January 1995 to give good time for implementation. Mr Broughton said that the longer the process would last, the greater the opportunity to spend time defining the regions. A project team could think through the criteria and look at a real working structure before defining the final regions. For example, while it might make sense now for B&W to have responsibility for Syria and Lebanon, over the longer term it may be better to manage Arabia as one unit. The CEC would then need to match individuals with the roles identified.
44. Two types of plan are needed. Firstly a conceptual paper setting out the criteria for, and a recommendation of, the responsibility for each market, and a blueprint on how to move forward, saying how each Operating Group should go about its plans for those markets. Mr Bramley suggested that Mr Norsworthy had relevant experience from his work on Rubicon, and his work for Mr Adams on the reorganisation of the Far East. He will contact Mr Norsworthy and arrange a meeting with Mr Herter and/or Mr Broughton. The Operating Group Chairmen suggested that the conceptual paper could be produced within a month, agreed at a further TSG meeting, and from that a vision of the future could be communicated. Mr Herter thought that this would take a year rather than a month.
45. Before implementation, plans would need to be made by each Operating Group for the myriad practical details such as EDP, control, manuals, setting out who would pay the salesman, how invoicing would be carried out, the price and terms, how to deal with local licenses by third parties. These plans might be co-ordinated by Miss Barton.
46. A financial paper will also be needed setting out the costs and the benefits which should be considerable from the opportunity to cut overheads.
47. The Operating Groups will, in the interim, continue to plan on the existing basis.

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**Communication**

48. The management teams are waiting for the outcome of the meeting. It was agreed that the TSG members should say that much progress had been made. Consensus has been reached on the concept of end market control. A feasibility study will now be made and if implementation is possible we will define the stages and time scale for implementation, including which individuals or management teams will be responsible for which markets. We would evolve towards "zones of influence", the territories in which would not necessarily be contiguous, and the responsibility for these territories would lie with the current management teams rather than with the Operating Groups. Mr Bramley suggested that it would be useful to have a set of Qs and As.

**Action Plan**

49. The action points were that:

- a) Mr Bramley would contact Mr Norworthy to develop a conceptual paper with Miss Barton. This paper will set out:
- the principles by which the end markets will be allocated to management teams, in the short term, and in the longer term if this is different;
  - the proposed allocation of markets based on these principles;
  - the practical issues that will have to be addressed, and the steps to be taken, market by market, to implement end market control;
  - identification and consideration of those strategic functions requiring direction and/or co-ordination from the centre;
  - the roles and responsibilities of the management teams and of the Tobacco Management Board.
- b) in order to move towards a definition of IBs, and to assist in prioritising them, Mr Bramley will ask Mr Bingham to prepare a report for the next TSG meeting on the total group-wide volume and market share of the group's top 20 brands (IBs and domestic brands) by market;
- c) Each Operating Group will examine the appropriateness of extending the use of the "British-American Tobacco" name;
- d) the Operating Group Chairmen will start to think about how they will plan the detailed logistics of moving to end market control within their own businesses;
- e) the Finance team will start to think about the financial implications and about management information requirements.

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