The Nexus Between Tobacco Manufacturers and Tobacco Retailers

A Brief History

The point-of-purchase is critical to tobacco sales. It is where the four Ps of a marketing plan—product, price, promotion, and place—unite and where, if successful, a shopper is converted into a buyer. Beginning in the early 1990s, as they faced growing restrictions on advertising and promotion, tobacco companies increasingly focused their attention and marketing dollars on point-of-sale promotion. The position, size, and type of tobacco display, and the location and number of company signs were specified in contractual agreements between tobacco companies and retailers. In exchange for complying with the tobacco companies' requirements regarding display space and store signage, retailers were paid promotional allowances in the form of cash, discounts, rebates, merchandise, fixtures, prizes, or some combination of these.[1]

> "The closer we are to the retailer, the closer we are to the consumer"
> British American Tobacco, 2010

New Retailer Performance Payments

Following the implementation of display bans across Canada, tobacco company payments to retailers declined significantly, from a peak of $108M in 2007 to $19M in 2010, the year the last province imposed a display ban.[2] Since then, tobacco manufacturers have redirected their promotional budgets from paying retailers for "visual communication," i.e., prominent display space, to establishing partnerships with retailers to achieve "category growth." According to Imperial Tobacco's then Vice-President of Marketing, the retailers "[w]ho can work with the manufacturer to get growth will have growth, see benefits, savings, plus ongoing benefits like customer loyalty.'"[3] Given Canada's dark market, the principal way to achieve "category growth" is through lower cigarette prices, which became the new focus of retailer programs.

Imperial Tobacco Canada was the first to transform its relationship with retailers, establishing Direct to Store Sales (DSS) in 2006. By eliminating wholesalers/ distributors, Imperial was able to exert greater control over retailers, in particular their pricing, and establish a direct communications channel to consumers. In 2012 Rothmans, Benson & Hedges implemented its own direct to store delivery. (JTI-Macdonald, Canada's smallest tobacco company with an estimated 12% market share,[4] continues to use wholesalers/distributors.)

Eliminating distributors changed the relationship between retailers and tobacco company sales representatives. Sales representatives visit key accounts regularly, as often as three times in an 8-week period.[5] Their role is to educate retailers on industry trends and the company's brands, including features, changes, and new brands; train retailers on the proper communication of brand attributes to customers and use of trade support tools; educate retailers on

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[1] Tilson Consulting. Restrictions on the Retail Display of Tobacco Products: Policy Analysis. Prepared for Smoke-Free Nova Scotia. August 2004.
[2] Physicians for a Smoke-Free Canada. Loyalty Programs and Other Incentives for Retailers to Sell Cigarettes: An Exploratory Research Project. August 2016.
[3] Jaclyn Greenberg. Life After Dark. Realizing the opportunity in your dark market. Convenience Central. July 2008.
[4] K Gray. Where There Is Smoke: Canada's tobacco trade is undergoing significant change with new regulations, new products and new attitudes. Your Convenience Manager. November-December 2015.
[5] Physicians for a Smoke-Free Canada. Loyalty Programs and Other Incentives for Retailers to Sell Cigarettes: An Exploratory Research Project. August 2016.

inventory management (rotating stock to ensure product freshness, not running out of stock) and the importance of offering a wide range of SKUs (brands and brand variants); monitor retailers' performance, including through the use of test shoppers; discuss issues related to pricing and profit margins; and negotiate and ensure compliance with contracts.[6] In short, tobacco manufacturers through their sales representatives and negotiated contracts require retailers to

- maintain a full range of products,
- be knowledgeable about cigarette brands,
- provide customers with information about cigarette brands,
- provide manufacturers with information about retail conditions, and
- accept price ceilings on lower-priced brands.

> "'It's very important to get the price right, because now people are very sensitive to pricing…. My price is not high, because we just signed a contract with a supplier who has a price ceiling. In order to get certain discounts for cartons of cigarettes, we can't sell higher than the price they set for us.'"
> S Li, Owner, Quick Plus Convenience, Halifax

Under these confidential contracts, manufacturers provide retailers with wholesale price discounts, prizes, and other financial incentives. While the major elements of these programs have remained consistent, the precise terms have evolved over the past decade. Imperial Tobacco, for example, launched CORE in 2008, which became the EXPANSION Preferred Pricing Program in 2010. Both programs offer retailers lower wholesale prices for volume sales; however, the Expansion program *requires* retailers to pass on the discount to their customers, rather than using it to boost their own profits. As well, the Expansion program was offered to only 10,000 selected chain and independent convenience stores, which excluded two-thirds of Canadian cigarette retailers. Participating retailers were sold Imperial products at $5–$6 less per carton than non-participants. Eligibility for the program is determined by a retailer's product volume and geographical location and the demographic profile of the neighbourhood. Retailers who are not part of the program face competitive pressure to lower their prices and reduce their margins.

Like Imperial, Rothmans, Benson & Hedges (RBH) has adjusted its retailer programs over the past ten years. Launched in 2009, its CONNECT program focused on providing licensed tobacco retailers with sales training and product education through a secure website. Retailers were encouraged to log on to the website frequently with interactive contests that awarded loyalty points and prizes for correctly answering questions about RBH brands, completing surveys, etc.

In 2014, RBH renamed the program CONNEXIONS and introduced preferential pricing, offering participating retailers rebates and price discounts. The discounts vary by the brand's price tier (premium, mid-tier, budget) and by retailer. In exchange for these wholesale price discounts, RBH dictates the retailer's selling price, particularly on budget brands, and imposes sales volume targets.

Another key feature of the Connexions program is its emphasis on data collection. To help retailers reach their sales targets, RBH sales representatives share store performance data with retailers, allowing them to compare their sales of RBH products to the previous year and to their competitors in their trading area:

> *Better data means individual sales reps will now have a better understanding of the market each store operates in, and Connexions means both the sales rep and the retailer will have more time to tailor sales strategies that work for each store."*[7]

[6] Physicians for a Smoke-Free Canada. Loyalty Programs and Other Incentives for Retailers to Sell Cigarettes: An Exploratory Research Project. August 2016.

[7] L Earle. Connecting with Customers: RBH Launches Connexions to Build Retailer Relationships. Your Convenience Manager. September–October 2014.

Why Retailer Programs Are A Public Health Concern

A substantial body of research from many countries over many decades shows that significantly increasing the price of tobacco products, particularly through tobacco tax increases, is the single most consistently effective intervention for reducing tobacco use.[8] The current retailer incentive programs of Canada's major tobacco companies, Imperial Tobacco Canada and Rothmans, Benson & Hedges, offer participating retailers significant discounts on the wholesale prices of cigarettes, particularly lower-priced brands, in exchange for the retailers following the manufacturers' dictates regarding the absolute selling price or the price ceiling. This requirement serves to artificially lower the market price of certain (discount) brands, which is key to attracting and keeping price sensitive smokers. The artificially low prices offered by participating retailers in turn puts pressure on neighbouring retailers to reduce their own prices. Because participants are also required to meet sales targets, these retailer programs can result in other types of aggressive price-based promotion, such as multi-pack discounts and selling stock at cost or even at a loss.[9]

Manufacturer payments to retailers, whether in the form of price discounts, other financial rewards, or loyalty points that can be redeemed for prizes including merchandise and trips, also generate loyalty to tobacco companies. This loyalty undermines tobacco control when retailers willingly serve as fronts for the tobacco industry, lobbying against tobacco control reforms on the basis of industry arguments.[10]

Quebec's Attempt to Eliminate Retailer Incentive Payments[11]

As the manufacturer incentive programs intensified, so too did the disparity between retailers based on their inclusion in or exclusion from these programs. In 2015, the Quebec Coalition for Tobacco Control (QCTC) received a number of anonymous emails from independent retailers complaining about the programs. The QCTC obtained samples of retailer contracts and provided them to politicians, who raised the alarm bells during legislative hearings in 2015. As a result, the Quebec government banned the offering of incentives and rewards to retailers linked to sales and price conditions, as part of its overall reform of the Quebec *Tobacco Act*.

Since the ban came into effect in November 2016, retailers have complained that retailer programs have continued, including incentives linked to cigarette prices and sales. Indeed, a detailed analysis of cigarettes prices across Quebec conducted in 2017 revealed that high levels of price differentiation by brand, by retailer, and by retailer location continue to exist.

Conclusions

From a single price market until the early 2000s, the cigarette market in Canada has evolved into one with intense price competition with each of the Big Three tobacco companies offering brands in at least three different price categories—premium, mid-tier/discount, and value/budget. Pricing has become the primary vehicle for tobacco companies to attract new consumers and retain existing ones, and retail programs have become the cornerstone of the

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[8] U.S. National Cancer Institute and World Health Organization. The Economics of Tobacco and Tobacco Control. National Cancer Institute Tobacco Control Monograph 21. 2016.

[9] Quebec Coalition for Tobacco Control. Presentation. Industry Retail Programs: How the Tobacco Industry Controls Retailers and Implements its Price Segmentation Strategy. 13 February 2018.

[10] See, for example, T Blackwell. Leaked Big Tobacco document suggests it used convenience-store, anti-contraband groups as lobbyists. National Post. 25 October 2016.

[11] Quebec Coalition for Tobacco Control. Presentation. Industry Retail Programs: How the Tobacco Industry Controls Retailers and Implements its Price Segmentation Strategy. 13 February 2018.

industry's price-based strategies. While tobacco companies have long offered financial incentives tied to sales, retailer programs now focus on price, with retailer discounts contingent on compliance with the manufacturers' pricing policies.

Given the importance of price to tobacco consumption, it is imperative that governments implement measures to limit the ability of tobacco manufacturers and retailers to manipulate price to maximize sales. While there are a number of possible ways to do this, each has significant limitations:

1. Prohibit incentive payments to retailers

At present, not enough is known about Quebec's experience in legislating a prohibition on incentive payments to retailers and whether the prohibition has been unsuccessful because of a loophole in the law or inadequate enforcement. Thus, there is merit in other jurisdictions seeking to regulate such payments.

Another option would be for jurisdictions that require tobacco retailers to be licensed to make the disclosure of any contract with a tobacco manufacturer one of the licensing conditions. This transparency alone would benefit tobacco control, as it would provide greater insight into tobacco company manipulation of retailers and would be a disincentive for companies to pit one retailer against another. A second licensing requirement would be the retailer's declaration that s/he receives no form of financial incentive from a tobacco company tied to sales. Failure to provide a copy of the contract to the licensing authority would result in suspension or loss of the retailer's licence to sell tobacco, as would violation of the prohibition against accepting financial benefits related to tobacco sales.

2. Impose a minimum retail price

Requiring retailers to charge a minimum retail price for tobacco products would solve some of the problems related to the current price-segmented market, likely reducing the price spread between budget and premium brands. It would also reduce the ability of tobacco companies to impose an artificially low price ceiling on budget brands. It would not address volume discounts or preferential pricing for some retailers. In addition, many in tobacco control oppose a minimum price because without a concomitant increase in excise tax, tobacco companies would stand to gain windfall profits.[12]

3. Mandate standardized pricing

This option is beginning to garner discussion in the tobacco control community. A mandatory standardized price means that retailers would be required to charge a standard per unit price for every category of tobacco product; in other words, all regular cigarettes would cost the same, regardless of brand. This would eliminate the tobacco companies' price segmentation. It would also end price variations between retailers, whether based on the retailer's sales volume or on the manufacturer's per carton discount, and the selling of tobacco products below cost. As the most restrictive option, garnering public and political support for this measure would be challenging and would likely require a sustained and highly focused campaign.[13]

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[12] See ChangeLab Solutions. Webinar. Tobacco Minimum Pricing Laws. 30 October 2014.

[13] For a more detailed discussion of pricing options, see Non-Smokers' Rights Association/Smoking and Health Action Foundation. A Comprehensive Pricing Strategy for Tobacco Products. March 2017.