Thinking the “unthinkable”: why Philip Morris considered quitting

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METHODS

Data were collected from the Philip Morris Incorporated document website (http://www.pmdocs.com/), which provides access to millions of company documents released as a result of state attorneys general lawsuits and other cases. Between 15 January 2002 and 9 July 2002, we searched the Philip Morris website for documents related to the company's identity and reactions to public pressure. We used a variety of search terms including “image management” and “identity”. Searches were extended using names of individuals and consulting companies, dates, and other indexing information in a “snowball” search strategy. Further information on document collections and searching strategies is provided in earlier work. To facilitate ongoing access, we have replaced the Philip Morris website URLs in our citations with URLs of the same documents available on the Legacy Tobacco Documents Library website, which will remain accessible to the public after the industry sites are closed. We reviewed more than 400 company documents, Lexis/Nexis searches of more than 50 major newspapers, and relevant Securities and Exchange Commission filings. We analysed the documents using a chronological case study approach.

FINDINGS

Corporate image became a major concern for Philip Morris in the late 1980s. This concern derived from executives’ perception—confirmed by extensive research—that the company had a poor reputation with the public and with legislators and other opinion leaders. In company ordered opinion polls, Philip Morris was consistently rated less favourably than other major companies, including Exxon, despite the highly publicised 1989 Exxon Valdez oil spill. A 1990 Roper study concluded that Philip Morris experienced a “decline in popularity” between 1980 and 1990, even though “large corporations in general” were rated more positively at the end of the decade. Philip Morris even fared poorly compared to RJR Nabisco (RJR), its closest tobacco competitor. Philip Morris’s pollsters, the Wirthlin Group, attributed RJR’s relative popularity to its success “in obscuring its tobacco company association.”

Even without this research, Philip Morris executives were cognisant of their image problem. Consultants and executives used startling language to describe themselves and their business. At a 1991 meeting, image consultants likened the business to prostitution, alcoholism, and drug trafficking. They suggested that Philip Morris’s position was similar to “VW after WWII”—that is, a company known for doing business with Nazis. “Who were the bad boys over this past century—what happened to them?” one of the consultants asked, evidently looking for a model. At one meeting executives were asked to consider the actions of the asbestos industry in their brainstorming. A team organised to work on the “declining media climate” unanimously agreed that the “situation is rapidly deteriorating.” The health hazards of tobacco
use were central to the problem (fig 1). A few years later, a Corporate Communications Taskforce summarised media perception of the company as “evil . . . selling a lethal product”.

That perception was causing some institutional investors— notably Harvard, Johns Hopkins, and the City University of New York—to divest their portfolios of tobacco stock. Divestment may have been particularly alarming because a survey of stock analysts declared Philip Morris to be “primarily a stock for professional or institutional investors.” Whereas individuals make investment decisions based in part on “emotion,” and thus might be reluctant to buy tobacco stock, institutions “only care about making money.” If institutions were divesting, there was cause for concern. Image also affected stock price directly. Philip Morris’s public relations firm told the company that “as [the] ‘tobacco’ image of Philip Morris increases, [the] market value of Philip Morris decreases.” Analysts told Philip Morris that “their clients discount the price they’ll pay for Philip Morris by about 40 percent because of the ‘litigation time bomb’”—the fear that Philip Morris’s winning streak in the courts would end.

Employee morale was a related problem. Philip Morris executives made repeated references to this concern from the early 1990s on. In 1990, RW Murray, vice chairman of Philip Morris Corporation, worried that “severe morale problems” could arise “in the next few years”. By 1993, such problems were noticeable to outside board members, who remarked that they were “expected when a company is going down, but PM USA is still wildly profitable”. A year later, Murray said that morale was his “one significant concern about our future tobacco business”. Philip Morris’s acquisition of Kraft in 1988 may have exacerbated these problems, since food employees were not necessarily eager to work for a tobacco company. After the Kraft merger one employee asked whether “we really want our food customers to know that we are owned by a cigarette company?” Murray responded that none of the operating companies “need be ashamed to be associated with” the others.

Company image problems derived from several sources, including litigation threats, increased regulatory efforts on the federal, state, and local levels, and a shrinking domestic market for tobacco. Philip Morris management attributed these factors to the increased effectiveness of the tobacco control movement. As early as 1987, minutes from a brainstorming session on environmental tobacco smoke declared that in the USA the tobacco “industry is going down” and tobacco control forces were characterised as a “REAL ADVERSARY” (emphasis in original). In 1990, Murray commented that the “large number of anti-smoking activists in America” were “effective and becoming more so.” John Dollisson, the vice president of corporate affairs at Philip Morris International, warned Infotab, the industry’s international intelligence and research organisation, that it was time to “wake up to the fact that we are loosing [sic] the battle” and that many of “the enemy . . . really are a lot smarter than we are” (emphasis in original). The business climate, another executive agreed, was “terrible” as a result of “25 years of criticisms” and the “rise of public health advocacy groups”. Senior vice president Marc Goldberg declared: “Anti-tobacco sentiment has infected a wide range of our business operations and performance.”

This “sea change” in the business climate, as CEO Michael A Miles characterised it, called for strong measures.

**STRATEGIES**

**Dump tobacco**

The most extreme possibilities Philip Morris considered were getting out of or “skimming off” the tobacco business. In 1987, before the Kraft acquisition, some executives suggested that Philip Morris should assume it was playing an “end game” and “maximize cash flow”—that is, focus exclusively on short term profits. Such a “controlled retreat” would probably accelerate “into an abrupt end” they thought, so “fighting back” was preferable. By 1990, when a larger proportion of profits came from food products, this conclusion was no longer given. In that year, vice chairman Murray wrote that “tobacco is a [sic] could be a dying industry”. He continued: “I think we all believe that our future lies outside tobacco, and principally in the food business. I certainly believe this.” The liabilities of tobacco were heavy and would probably get worse. Murray outlined two options: selling the tobacco business, or improving the business environment. Ultimately, Murray recommended that the latter be tried, but “If at the end of two years
it looks like it is not working we should . . . get rid of the tobacco business”. 43 A few months later Murray wrote that the company should “have [a] spin-off plan on [the] shelf ready to go”. 44

In 1993, a year after Murray’s deadline, board of directors member William Donaldson suggested that they “consider the ‘unthinkable’—look at the skin off idea”. 45 In 1994 a formal proposal was made to the board, with the support of senior management, 21 to separate the food and tobacco businesses. The idea was to “spin off” the food companies (Kraft General Foods, both domestic and international), giving shareholders in Philip Morris equivalent shares in the new entity. Another, similar plan, separated domestic tobacco from food, beer, and international tobacco interests. The objectives were to cash (“monetize”) Domestic Tobacco’s (“DT’s”) . . . value and “separate DT from [Philip Morris] thereby clarifying [Philip Morris’s] valuation”. 46

The problem with Philip Morris’s valuation was that food companies tended to have higher price/earnings (PE) multiples than tobacco companies, and, as far as the market was concerned, Philip Morris traded “like a domestic tobacco company—not like a food company”. 47 Thus when Philip Morris acquired new food operations, they paid “food industry multiples . . . which are subsequently valued at the company’s lower . . . multiples”. 48 In other words, because Philip Morris was a tobacco company, its purchases immediately lost value because of the association. This made “acquisitions difficult to justify financially”. 49

In similar circumstances, RJR Nabisco had made a less extreme proposal in 1993. The company had proposed to issue “targeted stock” that would follow its food businesses. In RJR Nabisco’s case, however, the division would have been only on paper, with the company remaining intact, sharing assets and liabilities. Stockholders in the food company would not have been protected from losses in court by the tobacco side. 50 RJR Nabisco’s proposal was withdrawn because of “trepid” demand for the new stock.

The most detailed description of Philip Morris’s spin-off plan, a speech delivered by Marc Goldberg to the board, argued that it would improve the fortunes of both food and tobacco. The food company’s PE multiple would go up, its employees’ morale would improve (in part because of the increased value of their stock holdings), and it would no longer be vulnerable to actions such as the INFECT boycott of Kraft products (www.infect.org). On the tobacco side, Goldberg said, the company would be able to respond to actions against it without worrying about the impact on food (for example, fighting McDonald’s decision to go smoke-free without damaging its relationship with Kraft) and “to pursue different financial strategies for each part of the business”. 51

There were some hints that this strategy might not be quite as effective for the tobacco business as Goldberg implied. Goldberg claimed that “new tobacco investors would more likely be sophisticated about the stock market realities of investing in a tobacco stock” and would therefore react less precipitously to bad news. However, he also asserted that employees’ “incentive compensation would be more cash based than stock based”. 52 This suggests that he did not believe that the stock value on the tobacco side would improve as it was expected to do for food. Indeed, one stock analyst asked whether “anyone on earth would invest in a pure tobacco firm”. 53

Nonetheless, Philip Morris’s spin-off plan had the support of “all members of senior management”, 54 including Philip Morris CEO Miles. 55 (Miles, the only non-tobacco man ever to head Philip Morris, had previously been the CEO of Kraft.) Miles attributed his support of this strategy to “the environmental problems facing our US tobacco business”, specifically “negative media coverage”, “the barrage of litigation”, and INFECT’s initiation of “the first serious organized boycott effort directed against our non tobacco products”. 56

Philip Morris floated the spin-off idea to the business community in April 1994. 57 The announcement that the company was considering such a move caused its stock to rise in the ensuing weeks. 58 Business reporters agreed with company management’s assessment of the situation: the tobacco business, particularly because of “a growing wave of anti-smoking sentiment”, 59 was devaluing the food business. 60 61 62

The spin-off proposal was recommended for consideration to the board in April 1994, but withdrawn a month later on the advice of attorneys at Shook Hardy & Bacon and Arnold & Porter. 63 Shortly after that, Miles stepped down, replaced by Murray and Geoffrey Bible, both long term tobacco executives. It does not appear that getting rid of tobacco was ever seriously raised again.

### IMAGE

Even as they were considering the spin-off, the company was developing other options. These ranged from “ferocious defense” (organizing politically and approaching the media more aggressively) 64 to “Project Rainbow” (making strategic concessions to Congress in exchange for a period of “peace”). 65 66 67 Along with these strategies, company management emphasised image enhancement, a project in the works since 1989, culminating in the “Altria” name change. The Kraft takeover meant that a third of Philip Morris’s income would come from food. 68 That shift in the balance, along with the acquisition of Kraft management’s more aggressive style, 69 70 71 inspired a plan to “change the image of the company from that of a tobacco company to a large, agriculturally based consumer goods business”. 72 The public relations firm Burson Marsteller warned that such a change would take “courage and discipline”. It would not occur if management violated the commandment “Thou shalt not BS thyself” by complaining that “media coverage is unfair” or simply asserting “we aren’t a tobacco company”. 73 74 The project had two parts: company positioning and corporate name change.

#### Positioning

In 1993, the Wirthlin Group developed a set of possible “positioning concepts” for the company. The difficulty was finding a defensible position that bore a convincing relationship to the reality of Philip Morris. A good statement should “build on the positive impressions that . . . stakeholder groups already hold”. But Philip Morris’s “perceived strengths”, which included its size and contribution to the economy, were not as important to consumers as trustworthiness and caring about consumer health, attributes which it was very difficult for Philip Morris to claim. 75 When concepts such as community commitment, good employee relations, and providing choice were attached to the Philip Morris name, surveys showed they all raised its image rating from the low 30s to 55–63 on a 100 point scale. But the consultants also pointed out that “ ratings for a ‘generic’ company that meets any of the above descriptions is [sic] between 75–80”. 76 77

Philip Morris’s response was “PM21” or “Philip Morris in the 21st Century.” This project involved several components designed to improve the company image, including a “Youth Smoking Prevention” project, 78 79 and refining and publicising the company’s corporate giving programme. 80 81 82 The project also had an internal component, designed to make employees feel more positively about the company. 83 84

#### Name change

The culmination of PM21 was the announcement in 2001 of the intention to change the company name to “The Altria Group”. The primary reason for the name change was to “reduce the drag on the company’s reputation that association with the world’s most famous cigarette maker has caused”. 85 86

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This paraphrase precisely conveys Philip Morris's hopes. Although it might be “associated with” tobacco, the company’s primary identity would be something quite different. The company wanted to sever its image from tobacco without severing its financial ties.11

DISCUSSION

The tobacco control movement, which significantly changed public policies and public views on tobacco regulation during the late 1980s and early 1990s, was possibly even more effective than previously understood. This examination of internal Philip Morris documents shows how the company viewed its future prospects when tobacco control was in its ascendancy. Industry focused activism pushed the company to the "contemplation stage"; inspiring high level corporate discussion about the future viability of the tobacco business. Specific concerns raised by Philip Morris included an increasingly negative media climate, boycott actions by groups such as INFACT, the drag of litigation risk on non-tobacco operating companies, conflicts between tobacco and non-tobacco companies under the Philip Morris corporate umbrella, declining employee morale because of the increasing social unacceptability of the industry, and public policy changes that reduced marketing opportunities and decreased tobacco use.

Had Philip Morris acceded to these pressures by selling its tobacco business, the immediate impact on tobacco sales and consumption would have been minimal. Another company, such as RJ Reynolds or British American Tobacco, would have been eager to acquire the business, particularly the leading brand, Marlboro. However, the long term impact could have been substantial in several ways.

Such a move by the dominant US tobacco company would have been a clear indication that, regardless of profits, continuing in such a business was socially untenable. The political power Philip Morris amassed would no longer have been focused on legitimising tobacco, perhaps creating an opportunity for tobacco control gains at the federal level. The increased consolidation of the tobacco business in companies engaged solely in tobacco might have made their "social irresponsibility" more apparent, and made it easier to isolate those companies through strategies such as divestment. Some of these advantages might have also accrued to a lesser extent had Philip Morris only split the tobacco and food businesses.

While even the most ardent tobacco control advocates rarely imagine Philip Morris voluntarily getting out of the tobacco business, company documents show that such an option was on the table. The spin-off plan was taken further than the sell-off, but even that proposal shows the power of tobacco control. Indeed, Philip Morris’s spin-off plan was its own way of isolating the tobacco business from its food holdings in order to control the downsides that a strong tobacco control environment was exacerbating. The fact that these plans were abandoned in favour of an image makeover and name change does not detract from its significance. Rather, it provides evidence that even within the tobacco industry there was an emerging awareness that “business as usual” cannot continue indefinitely.

Leery of being tagged as prohibitionists, many public health advocates, practitioners, and policymakers have resisted articulating the goal of eliminating the industry. Some have suggested, implicitly or explicitly, that such a goal is inappropriate or impossible.12 Instead, they have focused their efforts on reducing youth access and youth directed marketing, and promoting smoke-free workplaces and public accommodations. These approaches, while well intentioned and effective, fail short of directly aiming for the smoke-free society envisioned almost 20 years ago by Surgeon General C Everett Koop.24

This study suggests that ongoing efforts aimed at de-normalising the industry have the potential to destabilise, reduce or even eventually eliminate the industrial production of tobacco. A decade ago, in the absence of any threat to the legality of tobacco, the largest US tobacco company considered either spinning off or exiting the “dying” business, in large part because of the effectiveness of tobacco control efforts. Elimination of tobacco as a corporate enterprise, therefore, should be distinguished from legal prohibition of tobacco products. Rather, as this study shows, phasing out the industry may be possible through a combination of public pressure, media attention, regulation, taxation, and litigation that disrupts the industry’s carefully crafted image and renders the business climate increasingly inhospitable. That Philip Morris continues to feel pressure from tobacco control initiatives such as the World Health Organization enquiry1 is evidenced by the company’s intention to change its name. Other strategies, such as generic packaging requirements, that reduce the value of branding also may be powerful tools for tobacco control. Such sustained, industry focused efforts may help Philip Morris—and other companies—eventually kick the tobacco habit for good.

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REFERENCES


What this paper adds

Research in the tobacco documents has focused on industry strategies designed to thwart tobacco control efforts in the scientific, legal, legislative, and regulatory arenas. Little work has addressed the efforts of tobacco control activists to alter the company's business environment. Company documents suggest that efforts to de-normalise the industry have figured prominently in the development of business strategies. Tobacco control activists have focused on minimising the harms of tobacco use by restricting marketing practices and promoting smoke-free public spaces, assuming that discussions of eliminating the industry were tantamount to calls for prohibition. This paper suggests that legal prohibition of tobacco is not a prerequisite for de-normalising, and perhaps eventually ending, the industrial production of tobacco.


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