

PHILIP MORRIS AND IQOS – GROWTH STRATEGY OR INNOVATION?

*Kveta Olsanova, Department of International Business, University of Economics, Prague
Nam. W Churchilla 1938/4, 13067 Prague 3, Czech Republic Kveta.Olsanova@vse.cz*

*Gina Cook, Department of Management, Metropolitan State University of Denver
Campus Box 78, PO Box 173362, Denver, CO 80217-3362 USA gcook13@msudenver.edu*

ABSTRACT

The study “Philip Morris and IQOS – A Growth Strategy or Innovation?” is a descriptive case focusing on the introduction of a new product in the tobacco industry. It examines the industry itself and the associated trends, including opportunities and challenges. The introduction of IOQS is examined within the framework of PMI’s corporate social responsibility strategy. Students are challenged to evaluate the circumstances surrounding the product’s introduction, and examine the coherency between CSR activities and introduction of a potentially harmful product. Students utilize critical thinking skills, practice communication, and use leadership skills within the context of small teams.

Keywords: Corporate Social Responsibility (CSR), Innovation, New Product Development

INTRODUCTION

IQOS is a pen-shaped device developed by Philip Morris International, Inc. that heats tobacco, instead of burning it. Since it heats the tobacco, it generates no smoke or ash, just a vapor containing nicotine. This device has been available since 2015 and is continuously being rolled-out globally. The new IQOS product, with fewer toxins, could eventually replace cigarettes in the long-term. The term “Reduced Risk Products” (RRPs) refers to the category currently driven by IQOS. The objective of this case is to evaluate PMI’s innovation in relation to its CSR strategies.

COMPETITIVE OVERVIEW

Three major international competitors – PMI, British American Tobacco P.L.C. (BAT) and Japan Tobacco International SA (JTI) have invested significantly into developing similar technologies and products. From a global perspective, the strongest competitive brand platforms in RRP are currently: IQOS (PMI), Glo and iFUSE (BAT) and Ploom Tech (JTI).

IQOS by PMI uses a specially designed tobacco stick product branded under the name HEETS, which is a complementary product to IQOS. PMI endorsed the HEETS brand by adding a product claim on the packaging: “Recommended by Marlboro”.

Glo was launched into Japan by BAT in December 2016. The product works by heating tobacco-containing “Neosticks” sold under the traditional Kent brand name. BAT has invested more than USD 1 billion over the past five years in commercializing this new generation of heating product (3).

Ploom Tech was launched by JTI into Japan in March 2016. It combines e-cigarette technology with “heat-not-burn”. This means that a container of liquid is heated and then passed through finely shredded tobacco as a vapor when it is used.

COMPANY OVERVIEW -- PMI

Philip Morris International Inc. (PMI) is an American global cigarette and tobacco company, with products sold in over 200 countries worldwide. In 2016, PMI manufactured and sold over 800 billion cigarettes to approximately 150 million adult consumers in more than 180 countries (9). Smoking rates in the United States continue to decrease. This highlights the risk for the cigarette producers that could be diversified by a tobacco risk reducing product.

PMI used to be an operating company of Altria Group. The spin-off in March 2008 was explained by Altria by arguing that PMI would have more "freedom" outside the constraints of US corporate ownership. Since the spin-off, Altria has focused on the United States, while PMI concentrates on international markets.

Altria has more than 8,000 employees and its wholly-owned subsidiaries include Philip Morris USA Inc., USSTC, John Middleton Co., Sherman Group Holdings, LLC, Nu Mark LLC, Ste. Michelle Wine Estates Ltd. and Philip Morris Capital Corporation. Altria holds an equity investment in AB InBev (the world's largest brewer with global brands Stella Artois, Corona and Budweiser). Altria's mission is to own and develop financially disciplined businesses that are leaders in responsibly providing adult tobacco and wine consumers with superior branded products (12).

HISTORICAL MILESTONES AT PMI – DEVELOPMENT OF RRPs

Development of the current RRP dates back to the 1970s when it was suggested that the ratio of tar to nicotine could be a way to safer smoking. Finding the right product satisfying smokers was not easy for the industry and was accompanied by many failures.

In 2007, the UK Royal College of Physicians published a report on tobacco harm reduction stating that if nicotine could be provided in a form that is acceptable and effective as a cigarette substitute, millions of lives could be saved. In 2008, the American Association of Public Health Physicians endorsed tobacco harm reduction as a strategy to reduce the risks associated with cigarette smoking. One year later, PMI officially opened its R&D facility dedicated to smoke-free products in Switzerland, followed by one in Singapore in 2010. The development of IQOS was undertaken. In 2014, they completed multiple studies on IQOS with very encouraging results.

Following the positive testing results and years of R&D efforts, they launched the testing phase of the IQOS in Italy and Japan in 2014. In 2015, they extended the study to a three-month clinical trial in Japan and the USA, and confirmed the positive results. IQOS was rolled out to Portugal, Romania, Russia, and Switzerland followed by other markets. In 2017, the product was available in 25 countries.

US LAUNCH OF IQOS

PMI submitted a Modified Risk Tobacco Product (MRTP) application for its electronically heated tobacco product, IQOS, to the US Food and Drug Administration (FDA) in 2016. After the official go ahead, Altria got exclusive rights to sell these products in the US market. In 2015, Altria and Philip Morris entered into a strategic agreement under which PMI markets Altria's MarkTen e-cigarettes internationally, while Altria distributes PMI's heated tobacco products in the US. (13).

Since the MRTP claim was approved by the FDA, the company holds a significant marketing advantage over other reduced risk tobacco products, including e-cigarettes, which are not allowed to make such a claim.

STRATEGIC CSR

In his famous 1970 New York Times Magazine headline “The Social Responsibility of Business Is to Increase Its Profits” Milton Friedman attacked the social responsibilities of business in a free-enterprise system. His followers argued that profitable corporations would create private wealth, which the private owners could then choose to channel towards philanthropic purposes.

Michael E. Porter and Mark R. Kramer have later brought the concept of shared value. Current definitions of CSR often illustrate a significant shift from the earlier philanthropic understandings of CSR towards a profound strategy covering all of a company’s stakeholders with philanthropy being just part of the overall strategy. Strategic CSR is about business creating *value* for stakeholders (15 p. 261).

Tobacco CSR strategies formulated by top global players are good examples of best CSR practices by companies that have already passed through their CSR threshold (15 p. 228) and were forced to take corrective actions. A CSR threshold is the point at which CSR becomes a necessary component of strategic success.

PHILIP MORRIS INTERNATIONAL AND CSR

For PMI, sustainability is “about seeking opportunities to create value while minimizing the negative externalities associated with our products” (1). CSR and sustainability are incorporated into the fundamentals of the PMI business strategy, driven by their vision of a smoke-free future, available in the “Sustainability Report” found at www.pmi.com.

It is important to report and measure KPIs for the strategic points listed in the company’s sustainable reporting. In PMI’s case, PwC was engaged to perform assurance procedures to provide reasonable assurance on the reporting of Business Transformation Metrics. Accordingly, the internal financial reporting guidelines are applied, the internal reporting systems to collect and aggregate the Business Transformation Metrics data are functioning as designed and provide an appropriate basis for reporting, and the data give a fair picture of PMI’s smoke-free products’ performance.

OPPORTUNITIES TO USE THE CASE

This case will work well in a marketing or international marketing class when discussing corporate social responsibility issues, strategic CSR, CSV, philanthropy and also product innovations. It is also appropriate for marketing communication classes, and could be used to debate issues associated with PR (CSR reporting, for example).

REFERENCES

References available upon request from the authors:
kveta.olsanova@vse.cz or gcook13@msudenver.edu