



**COALITION QUÉBÉCOISE
POUR LE CONTRÔLE DU TABAC**

Industry Retail Programs :
The Tobacco Industry's Price
Segmentation Tool

Flory Doucas

Quebec Coalition for Tobacco Control

November 28th, 2017



Tobacco retailer programs : What manufacturers have said about them

After the ban on visible retail displays came into force in Quebec, tobacco control advocates became alarmed with what they were reading in retail trade magazines. Canada's largest cigarette manufacturers were deploying retail reward programs :

- *Trips and prizes*
- *Rebates*
- *Other offers*

“We used to pay for space, visual communication, but now that the space is not there anymore the whole partnership is about category growth,” he said. Who can work with the manufacturer to get growth will have growth, see benefits, savings, plus ongoing benefits like customer loyalty.”

- Liel Miranda, division head, Trade Marketing, ITC, 2008. (YCM, July 2008)

Funk told retailers, “You can expect our company to not be paying for retail display space. But that is not meant to imply that we are taking trade spending off the table, not at all. In fact, we will migrate that trade spend into pay-for-performance kind of programs. So we will be focused on specific brands, on information that you can provide to your consumers,

- Ron Funk, VP Corporate Affairs RBH. (YCM, July 2008)

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Tobacco retailer programs : What retailers have said about them

HANK DANISZEWSKI, QMI AGENCY

Jan 15, 2011 , Last Updated: 5:45 AM ET

LONDON, Ont. - What's good news for London smokers may be bad for many small retailers as Canada's biggest tobacco company moves to drive down cigarette prices.

As of Nov. 1, Imperial Tobacco launched a new pricing program that gives about 10,000 retailers, roughly a third of all stores, a \$5-a-carton price break they're supposed to pass along to consumers.

Retailers who get the deal agree not to sell above a maximum price but can decide to sell for less.

The other retailers, though, are just out of luck. - [Toronto Sun](#), January 15, 2011

Sweaburg store owner argued Imperial Tobacco was giving out discounts on cigarettes to larger chain convenience stores.

SWEABURG -- A convenience store owner in Sweaburg who took Imperial Tobacco to task over what he called "unfair" prices offered to larger chain merchants has reached an agreement with the cigarette company to supply his store with a rebate.

Bob Pate, owner of Ritu's Convenience & Food Mart located at 484750 Sweaburg Road says his own profit on a package of cigarettes in February was just 20 cents. Now, he's able to offer more competitive prices on Imperial Tobacco's line after complaining to the company.

"They were giving big rebates to some stores which they selected and it was hurting my business and lots of small business owners. They talked to me several times, then they decided they understood the whole thing, and then they decided okay -- and gave my store the whole rebate, they're also giving other stores the rebates too."



Ritu's Convenience & Food Mart Owner Bob Pate (pictured) says his store will get a rebate after seeing discounts which varied anywhere from \$2.00 to \$10.00 per carton for other stores.

READ: Increasing gas station convenience increases sales

Recent activities by Imperial Tobacco have not helped. The Canada Convenience Store Retailers Association has filed a complaint with the commissioner of competition for Canada, claiming that Imperial Tobacco has offered its preferred pricing program to only 30 per cent of Canadian convenience stores.

That has left 70 per cent paying \$5 to \$9 more per carton, thereby squeezing their margins and forcing more stores to close.

The complaint makes other charges as well, summed up by the c-store association's claim that "Imperial's policies illustrate an abuse of market power, an abuse of dominance and contain exclusive dealing, tied selling and market restriction in favour of Imperial's products." (I contacted Imperial Tobacco to get its side of the story, but after three phone calls and three e-mail messages, I got no response). - [Canadian Grocer website](#), June 2013

Many retailers had actually protested publicly against the tobacco industry's retail programs, but health groups didn't pay much attention!

Tobacco retailer programs: What we now know

- *Retailers feel privileged to have retail trade agreements*
- *Contract/agreements have confidentiality clauses (often signed documents but not always)*

Agreements contain:

- *Price controls (fixed retailer profit margins), especially on discount brands*
- *Offer access to popular brands at competitive prices (4-6 \$ discounts in Qc)*
- *Offer access to special products (ex. specially bundled products, like « duo-packs »)*

Retailers must:

- *Not contest/question the conditions of the agreements*
- *Must reorder same or greater volumes (which implies that they must meet sales targets within specific periods)*
- *Must answer properly when quizzed by industry sales representatives*

LE DEVOIR

LE DEVOIR, LE LUNDI 26 OCTOBRE 2015

Tabac: des dépanneurs sous pression

Tobacco: convenience stores under pressure

[Translated by [COCT](#)]

ISABELLE PORTER | Quebec | October 26, 2015

Increasingly constrained by legislation, tobacco companies are now waging war convenience store by convenience store through "loyalty programs". For some small owners, the situation has become unbearable.

Charlie (not his real name) has owned a small convenience store in Montreal for six years. Although rather shy by nature, he does not hesitate to call himself "the slave" of the tobacco companies. Like everyone interviewed for this report, he has requested anonymity for fear of retaliatory trade measures from tobacco manufacturers.

It all started around 2009-2010, he says, when tobacco giant Japan Tobacco International (JTI) started selling cartons of Macdonald Special cigarettes to certain retailers at a deep discount. Retailers could pay five or six dollars less a carton but, in exchange, they had to sell packs for less. For selected stores, the agreement was even more rewarding,

Before any representatives come around, they will try to sell as many packs as possible of the brand under contract, sometimes selling it at a lower price, even at a loss. "I'll tell the customer that if he buys this brand, I will sell it for even less, except it's at my own expense," says Robert.

In the past, RBH and JTI have also offered retailers contracts based on point systems and contests to win prizes, including trips down South. Beyond these options, the principle is always the same: the company offers cartons at a discount, but sets the selling price. More and more retailers are also being offered discounts for two-pack combos (so-called "duo-packs") at a low price.

Previously, retailers would buy cartons from a wholesaler at the same price and sell them at a price of their choosing. But the tobacco companies now deliver their products themselves and send representatives to ensure that retailers

Imperial Tobacco is the only company to appear before the Parliamentary Committee, and responded to questions from Mr. Lisée about loyalty contracts. "The only thing retailers can do is answer some factual questions from consumers," argued spokesperson Eric Gagnon. "So if you're suggesting that Imperial Tobacco Canada, through partnership programs with retailers, incites people to smoke, that is completely wrong. What we do, with adults who have made a choice to smoke, is test our market share."

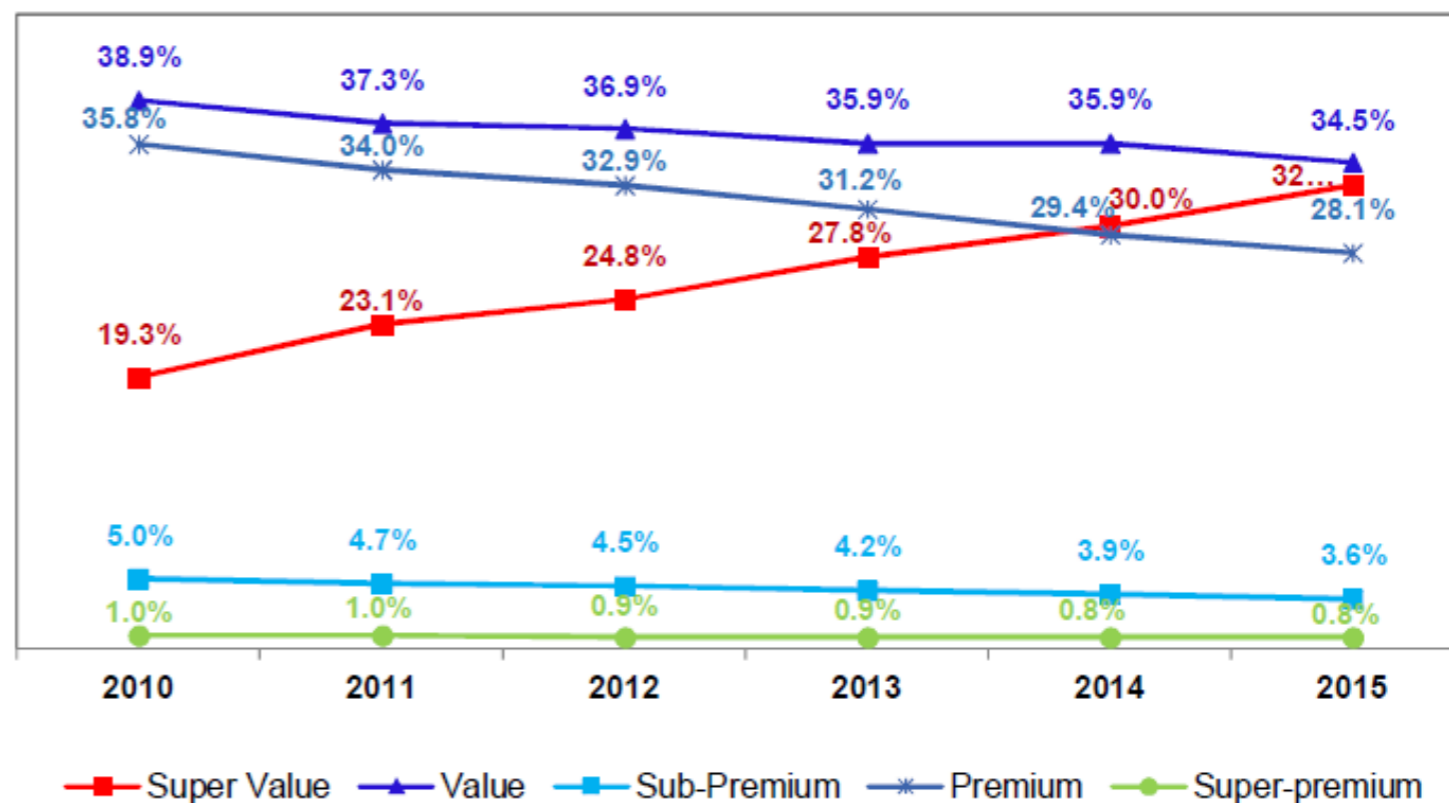
RBH is said to be "proud of its relationships with retailers." Those who participate "receive a special discount in exchange for a broader range of products, competitive prices and the guarantee of adequate inventory management," said the spokesperson contacted by *Le Devoir*. "This is a common business practice for many industries."

- Translation of an article where retailers confided to *Le Devoir* journalist in October 2015

http://www.cqct.qc.ca/Documents_docs/DOCU_2015/ART_15_10_26_Depanneurs_sous_pression_LEDevoir_ENG.pdf

Retailers incentive programs: What do they achieve

- *Allow manufacturers to keep prices artificially low by controlling profit margins*
- *Allow manufacturers to have complete control over pricing of discount brands, and finely modulate the prices of such brands over time*
- *Enable manufacturers to deploy price segmentation strategies*



Source: JTI's response to Health Canada's "Consultation on 'Plain and Standardized Packaging' for Tobacco Products", August 31, 2016.

Analysis of price displays in Quebec (1)

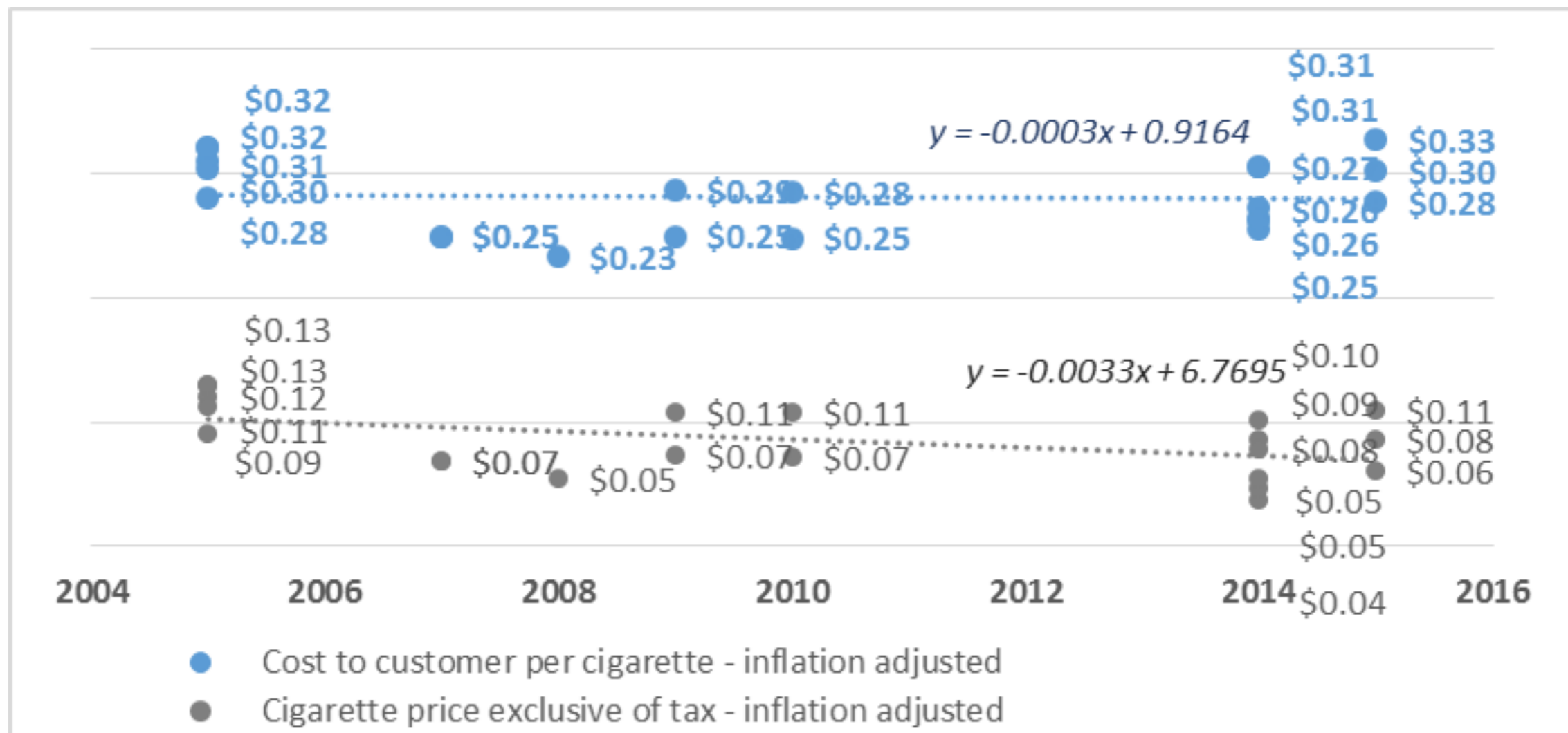


Example:

- *Factoring in for inflation, a consumer paid less for a discount brand in 2015, that he would have in 2005 (\$5.33 in 2005 is equivalent to \$6.27 in 2015.)*
- *The price displayed in 2015 (\$6.15) does not even account for the \$1.20 tax increases which occurred during that period, which would make it \$6.53*

Analysis of price displays in Quebec (2)

Lowest displayed price per cigarette and non-tax portion of price, (inflation adjusted, 2002=\$1). Quebec 2005-2015



- *Displayed price would lead to \$0.28-0.32/per cigarette in 2005 (max would lead \$ 6.40/pack of 20)*
- *Displayed price would lead to \$0.25-0.33/per cigarette in 2015 (max would lead \$ 6.60/pack of 20)*

What about segmentation in British Columbia ?

	20's
Budget Cigarettes from*	\$9.79
Value Cigarettes from*	\$10.29
Premium Cigarettes from*	\$11.25
US Brand Cigarettes from*	\$13.95
Budget Cartons from	\$95.90
Premium Cartons from	\$105.50

* when you purchase 2 packs

*Mac's Convenience store, Victoria, Nov. 26, 2017
picture courtesy of Jack Boomer*

- *The pictures tell us that there are:*
- *Price differences across cigarette brands*
- *Price differences based on the quantities bought (single packs, versus 2, versus carton)*
- *Prices vary from one location to the next*

STARTING AT	2 PACKS
\$11.26	\$10.97
\$10.23	\$9.35
\$10.23	\$9.67

*7-11, Victoria, Nov. 26, 2017
picture courtesy of Jack Boomer*

Hypocrisy of the industry

- The industry complains about taxes, but not its own increases

Nobody is immune to negative effect of contraband tobacco

CAROLINE FERLAND, SPECIAL TO THE VANCOUVER SUN | 10.30.2013 |

Caroline Ferland, vice-President, corporate affairs, at Imperial Tobacco Canada.



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As British Columbia completes its annual pre-budget consultation, the province would be wise to exercise extreme caution when it comes to tobacco taxation. While governments have been known to be quite addicted to tobacco taxes, and use taxation as an easy fix — as evidenced by the latest \$2-per-carton increase that took effect in B.C. on Oct. 1 — there are serious negative and unintended consequences that come with a high tax policy.

It does not take a degree in economics to figure out what happens when the price of a product is increased time and again: Consumers look for cheaper alternatives. When it comes to tobacco in Canada, that alternative is readily available through an illegal, untaxed and unregulated market.

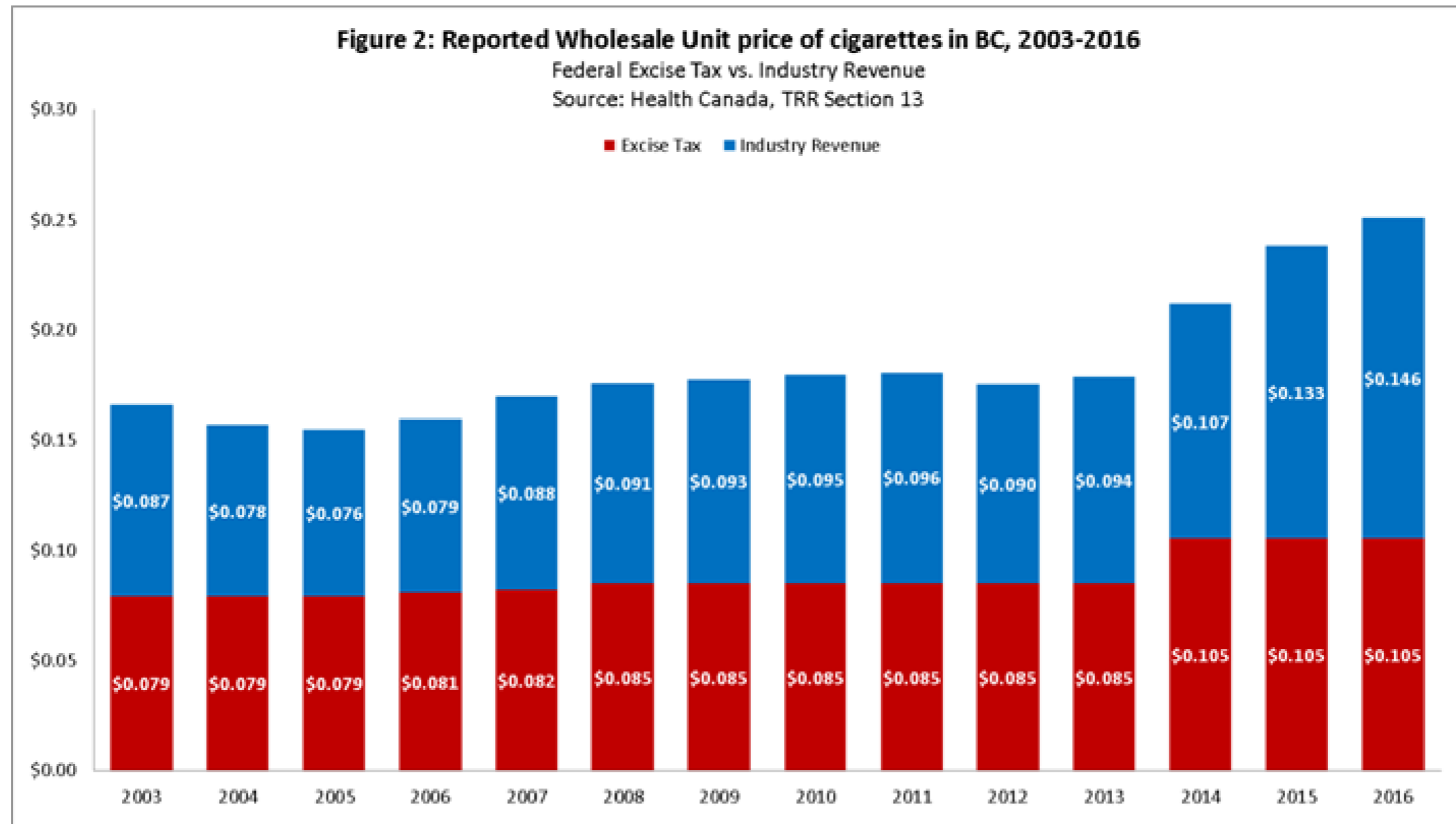
While B.C. is fortunate to have not yet seen illegal tobacco levels like those found in Ontario and Quebec, which reached 48 per cent and 40 per cent respectively in 2008, the threat remains very real. In recent years, illegal tobacco shipments from Ontario and Quebec have been seized across Canada, including in B.C.

In addition, B.C. faces another threat: counterfeit cigarette shipments from Asia. Since 2010, the RCMP has seized more than 145 million cigarettes illegally smuggled from Asia into the province. With the RCMP stating that they are only able to capture a fraction of the illegal cigarettes smuggled into Canada, we can only imagine the number of illegal cigarettes successfully penetrating B.C. from Asia.

Even more frightening for B.C. are the excessive tax increases in recent years in both Manitoba and Saskatchewan, which have provided a perfect opportunity for illegal operators to exploit the economic situation and begin transporting and selling illegal products in Western Canada. Manitoba has already seen its first "smoke shack" established and a noticeable spike in contraband seizures. As supply chains are established, it becomes easier to continue expanding westward towards B.C. If anyone has any doubts this will happen, they need only look to Atlantic Canada, where the illegal operators quickly expanded from their base in Ontario and Quebec and, according to a recent study by the Canadian

Wholesale price data for British Columbia

(wholesale does not include provincial taxes or retail margins)



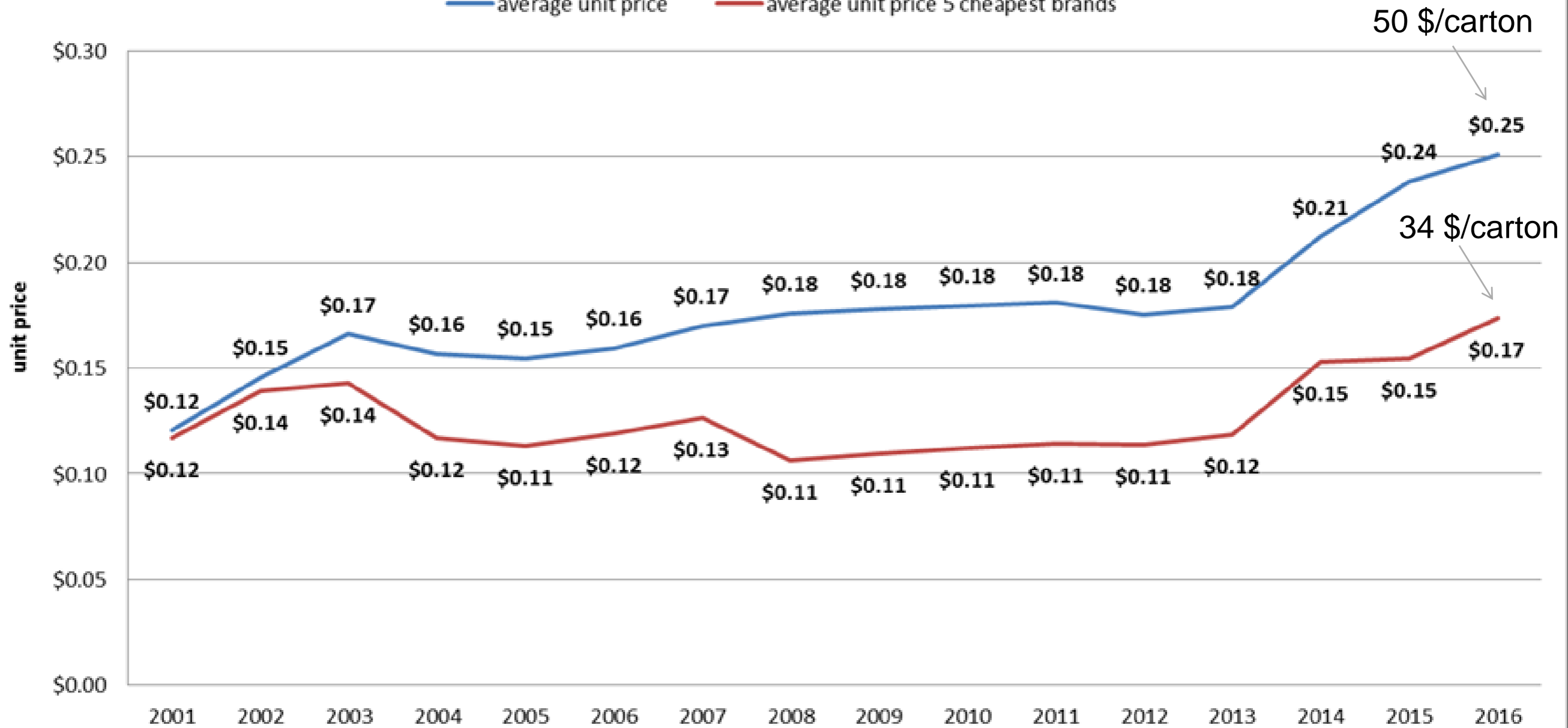
- Industry increased aggressively its prices between 2014 and 2016
- Average wholesale price for a carton went up \$ 7.80 during that period
- This increase is 4.87 times greater than the October 2017 increase (\$1.60)

Evolution of wholesale cigarette prices in BC

Average wholesale unit price of cigarettes in British Columbia, 2001-2016

Source: Health Canada, TRR Section 13

— average unit price — average unit price 5 cheapest brands

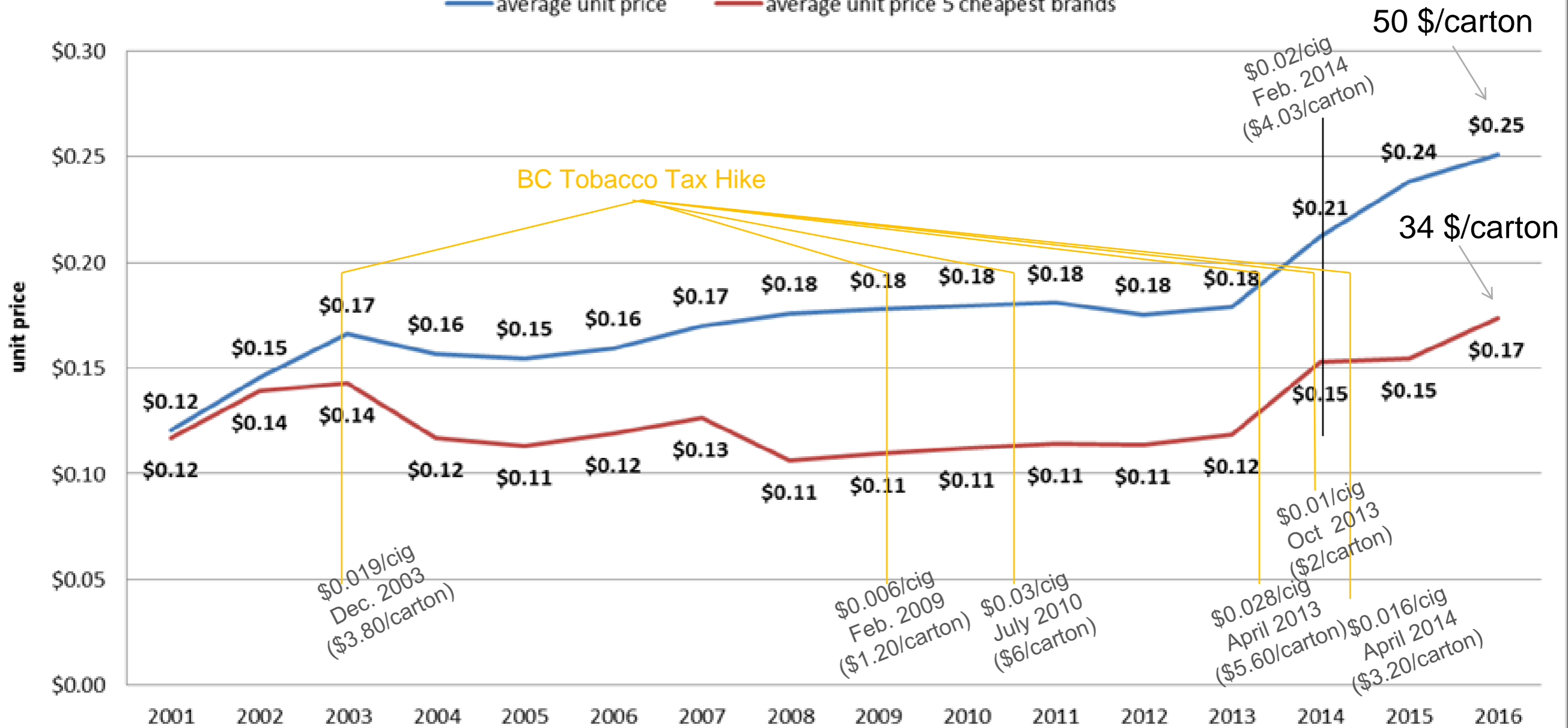


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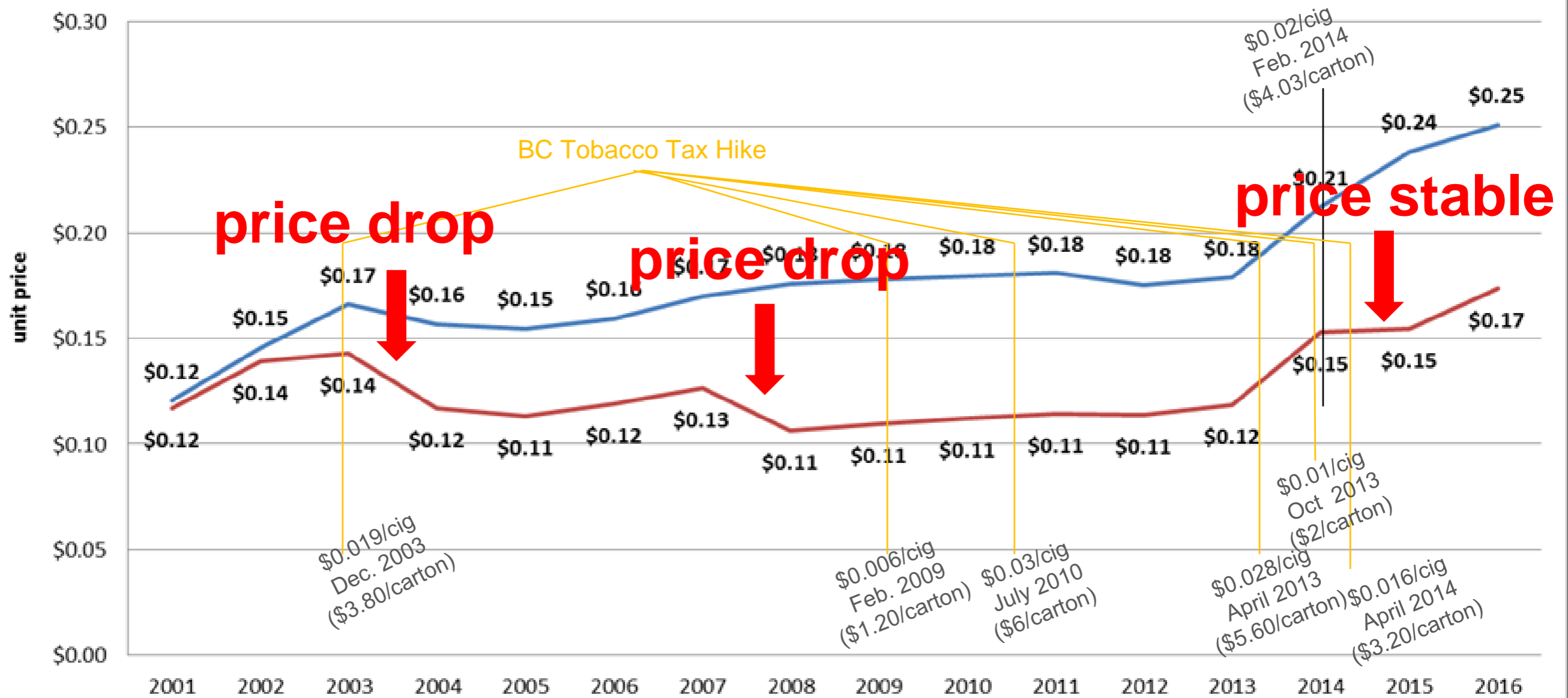


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The effect of price segmentation in the UK (2001-2009)

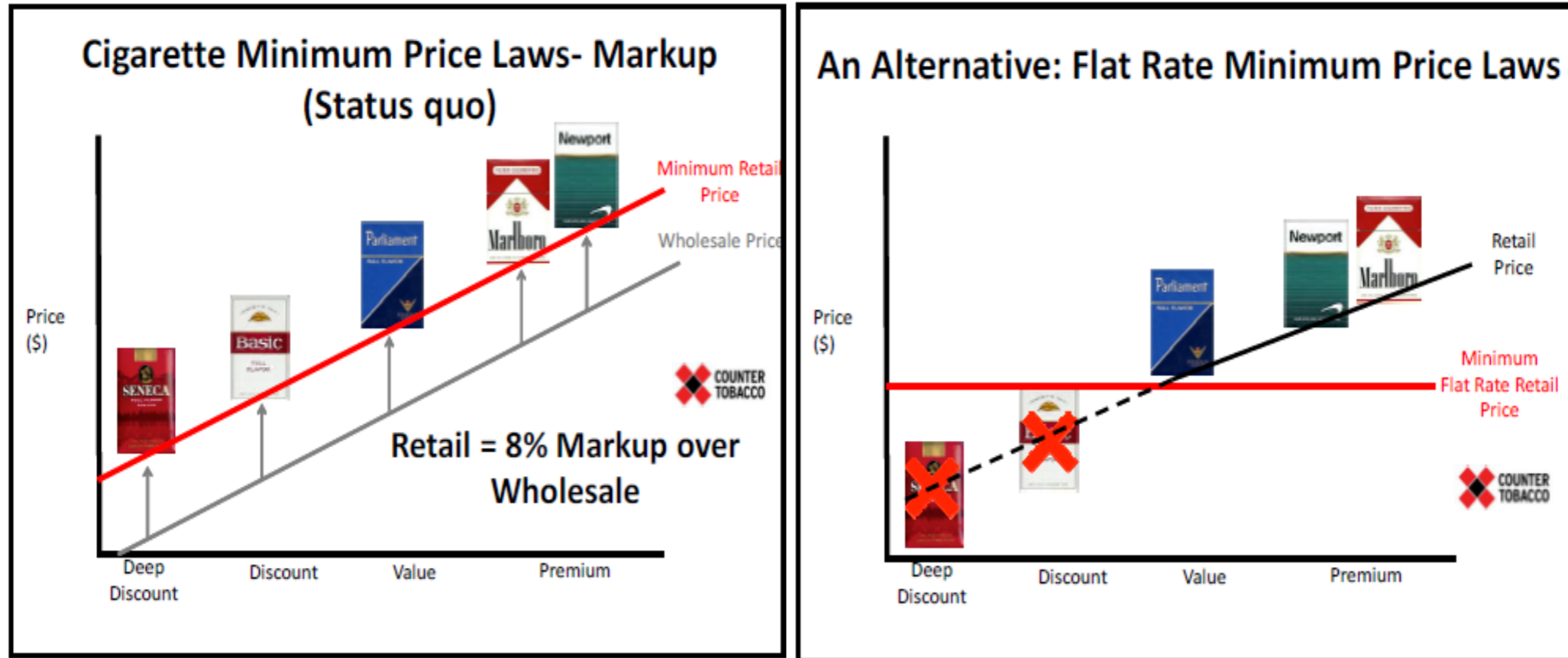
Across the market as a whole, the industry is increasing prices over and beyond tax increases (i.e. overshifting taxes)...However, the extent to which tax increases are shifted to smokers varies both over time and by brand segment

...

at the point when tobacco taxes are increased in March/April each year, the industry overshifts the tax increase on the more expensive brands, while absorbing the tax increase on ULP brands. This suggests that industry-initiated price changes are timed to reassure price-sensitive smokers and accentuate the price gap, but also to hide the price increases on the more expensive brands behind the excise increases.

Although the overshifting of taxes should benefit public health, the opportunities and incentives for consumers to downtrade from expensive to cheaper cigarettes have clearly increased over time and, if current pricing strategy continues, will increase further. Recent research showing that the availability of low cost cigarettes in a market reduces the effect of cigarette price increases in promoting smoking cessation suggests this pricing strategy may undermine the public health impact of tax increases.

Policy options : What about minimum prices ?



Source: **Public Health Law Center**, "Policy Options for combating Tobacco Industry Price Discounting", Webinar, April 3, 2012. <http://publichealthlawcenter.org/sites/default/files/Pricing%20Webinar%20-%20FINAL%20merged%20slides.pdf>.

- *Minimum price laws won't eliminate segmentation*

Policy options :

What about banning incentive programs, as Quebec did ?

“21.1. A manufacturer or distributor of tobacco products is prohibited from offering rebates, gratuities or any other form of benefit related to the sale or the retail price of a tobacco product to operators of tobacco retail outlets, including their employees. For the purposes of this section, a manufacturer or distributor of tobacco products includes the mandatary or representative of the manufacturer or distributor or a person or partnership that is controlled by or that controls the manufacturer or distributor.”

Quebec's 2015 Tobacco Control Act, <http://legisquebec.gouv.qc.ca/en/ShowDoc/cs/L-6.2>

- *Manufacturers can still vary (increase or lower) prices per brands in time : increasing them slowly in anticipation of tax hikes, and then lowering them to lessen the shock of a tax hike and not cause price shocks for the most price-sensitive consumers*
- *A rebate can be disguised as a lower service or delivery free for some retailers and not others*
- *Manufacturers can still offer cheaper prices to consumers based on whether they buy packs of 20, 25, bundled packs or cartons*

Policy options for better controls on prices

- Standardized price per unit, per same category of product (cigarettes) would eliminate:
- Price variations between brands
- Price variations between small vs large volume purchases
- Price variations between locations

Health groups (CQCT, and PSC) are asking governments to explore the standardized price option and implement price controls, so as not to undermine tax increases.

Impact on → Measure ↓	Price segmentation by brand:	Loss leaders/ products sold below cost:	Preferential pricing for some retailers:	Volume discounts:	Temporary price reductions:
Price cap	✓ (still possible, but less widespread)	✓ (still possible, but less profitable for tobacco companies)	✗ (still allowed)	✗ (still allowed)	✗ (still allowed)
Minimum price	✗ (still possible, but the price range will start higher)	✓ (more difficult - depending on the threshold price established)	✗ (still allowed)	✗ (still allowed)	✗ (still allowed)
Stable price over time	✗ (still allowed)	✗ (still allowed)	✗ (still allowed)	✗ (still allowed)	✓ (eliminated)
The same price by brand	✗ (still allowed)	✗ (still allowed)	✓ (eliminated)	✗ (still allowed)	✗ (still allowed)
The same price by unit and brand	✗ (still allowed)	✗ (still allowed)	✓ (eliminated)	✓ (eliminated)	✗ (still allowed)
The same price by unit for every category of tobacco product	✓ (eliminated)	✓ (eliminated)	✓ (eliminated)	✓ (eliminated)	✓ (eliminated)

Source: "Creating an optimal and coherent fiscal framework for tobacco, including a robust price policy." CQCT, April 2017
http://www.cqct.qc.ca/Documents_docs/DOCU_2017/MEMO_17_05_10_PricePolicyBrief_FINAL_V2.pdf



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Thank you!

I would like to acknowledge my colleague Heidi Rathjen (CQCT), as well as Cynthia Callard from Physicians for a Smoke-Free Canada (PSC) for their contributions to the material that inspired this presentation.

For more info:

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