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Commentary

Big tobacco, E-cigarettes, and a road to the smoking endgame

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ABSTRACT

The provision of the extraordinarily deadly product of cigarettes is dominated by a small number of large and incredibly profitable shareholder owned companies that are focussed on cigarettes. The legal duty of their managers to maximise shareholder wealth means that such companies vigorously fight any new public health measures that have the potential to disrupt their massive profit making, and have the resources to do so. Protecting the public health is therefore made a lot more difficult and expensive. We suggest that one way to counter this would be to actively design future tobacco control policies so that tobacco companies face mechanisms and incentives to develop in such a way that they no longer achieve the greatest shareholder value by focusing on cigarettes. A proper tobacco diversification and exit strategy for the shareholders of the profit-seeking tobacco industry would protect the public health by addressing the current addiction to the continuation of the cigarette market. The increasing popularity of e-cigarettes presents a particular opportunity in this regard, and we therefore suggest a possible policy response in order to start discussion in this area.

Introduction

In light of the fact that smoked tobacco (henceforth cigarettes for simplicity) is an extraordinarily deadly product, recent decades have witnessed a gradual increase in global tobacco control measures in order to reduce the multiple negative impacts upon society. Such measures have been fought by cigarette companies, thereby erecting significant obstacles to efforts to protect the public health. The basic problem is that selling cigarettes is incredibly profitable, especially in Western markets (Branston & Gilmore, 2014, 2015). For instance, in 2013 the profit of the world's top six tobacco companies was $44.1bn (Tobacco Atlas, 2015), the vast majority of which was earned from combustion products, whilst Imperial Tobacco the long-time market leader in the UK has been estimated to have earned profit margins of up to 68% in that market in recent years, which compares to a typical 12–20% margin for European non-tobacco consumer staple firms (Branston & Gilmore, 2015). A sequence of corporate mergers and takeovers mean that we now have a small number of large and extremely profitable transnational tobacco companies (TTC) dominating the global market for cigarettes outside China. These firms are strongly focussed on smoked tobacco, and overwhelmingly on cigarettes, and so have a very strong incentive to maintain their position and the current *status quo* in tobacco markets. Any attempt to introduce new public health measures which have the potential to disrupt the extremely lucrative cigarette business are fought 'tooth and nail', with states often facing massive legal bills if they are to successfully implement tobacco-control measures. Witness the reaction to the introduction of plain packaging in Australia (Chapman, 2012), the future implantation of this in the UK and Ireland (O'Faolain, 2015; BBC, 2015; Imperial Tobacco Plc, 2012; Japan Tobacco International Plc, 2012; McCabe, 2015; Thompson, 2012a, 2012b), and in the USA the successful legal challenge against the FDA's attempt to put graphic health warnings on cigarettes (Federal Drug Administration, 2015). The basic issue is that the TTC have every incentive to act in ways which prevent their extremely profitable market positions from being removed or eroded. It is logical for them to vigorously object to public health measures because these might restrict their business activities and

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thus the ability to maximise shareholder returns (i.e. profits), which is after all, the purpose of the modern shareholder owned corporation (Callard, Thompson, & Collishaw, 2005). Furthermore, the current extreme profitability of the TTC also gives them significant resources with which to go into 'battle' to protect their position and also to mitigate, bypass, and undermine any measures that are ultimately introduced. In short, the current structure of the tobacco industry is one which requires on-going and repeated battles with the industry for each and every public health measure in the area of tobacco control in each country. Like a cornered animal, or any army facing an enemy committed to their total annihilation, a corporation in such a situation will fight long, hard, and viciously.

If something could be done about the industry's incentives to act in this way, there would be significant gains to be had in terms of addressing the global cigarette smoking epidemic, most especially in developing markets where public health regulation is less developed. Tobacco related health measures might be more quickly, easily, and cheaply introduced, and would most likely be more effective too, leading to better health outcomes for the public. As a result, smoking rates might be more easily reduced. To do this, the nature of the incentives facing tobacco companies need to change. The companies need to be given a business environment that makes the marketing of cigarettes less appealing than other commercial opportunities on offer. Such policies have been effective in the past in helping to transition other industries toward products more beneficial to health. Consider, for example, the combination of regulation, and carrot and stick policies used to engender the transition from leaded petrol to unleaded petrol. Regulations that reduced and ultimately eliminated the use of lead in fuels in many countries combined with such things as the incompatibility of leaded fuel with the catalytic converters (mandated in the 1970s in the US under the Clean Air Act) to create change. Importantly, fiscal measures in jurisdictions such as Germany gave tax incentives to unleaded petrol that changed the economics, and thereby facilitated a transition to a less hazardous product that had been stymied for decades (Needleman & Gee, 2013).

In this regard existing tobacco control work looking at the tobacco industry has begun to develop a set of policies which might start to address the negative effects of the profit incentives currently faced by the TTC. These include policies that reduce the long-term profit potential of marketing cigarettes, such as: plain packaging; price cap regulation; limits on the composition of tobacco products; and even changing the structure of the commercial tobacco industry itself (Benowitz & Henningfield, 1994; Borland, 2003, 2012; Gilmore, Branston, & Sweanor, 2010; Hatsukami et al., 2010; Malone, 2010; Thomson, Wilson, Blakely, & Edwards, 2010). Each of these policies has its own merits but also reasons why they might be unappealing or difficult for politicians to implement (Bates, 2015). For instance, the suggestion that the tobacco industry be taken out of the private sector would require several hundred billion US dollars (just the value of the TTC on the FT500 currently exceeds US$550 billion, so adding in a premium to nationalise these companies, plus the many smaller companies, becomes an astronomical sum) so to buy out the existing companies would be hard to justify politically during a time of global austerity, especially with there being no guarantee that such an action would actually protect the public health. It is therefore likely that the commercial tobacco industry will be around for some time yet (most probably with increasing tobacco control regulation). It just need not be so single-mindedly focused on the marketing and sale of cigarettes (or other combustion-focused tobacco products), and thus the resulting epidemic of smoking-caused death and disease.

Immediate steps are therefore needed if the harm caused by the fiduciary obligation of the TTC's to maximise shareholder value is to start to be addressed in a meaningful way. Ideally such measures would complement and facilitate the introduction of further tobacco control measures, such as the aforementioned suggestions. One such policy is to regulate tobacco companies/tobacco markets and design future tobacco control measures in ways which avoid backing the companies into a combustion-focused corner. Public health goals can be hard enough to reach without unnecessarily turning the TTCs into cornered animals. An extremely profitable tobacco company that only operates in the cigarette dominated tobacco market has the ultimate incentive to fight tobacco control measures because the company might cease to exist without cigarettes. However, if the tobacco companies were provided an escape route outside the realm of cigarettes where they might go in their commercial activities, they might be less inclined to fight so hard for the continuation of tobacco markets as we know them. That is to say, to implement tobacco industry policies in such a way that gives shareholders of TTC a mechanism and incentive to develop their businesses in ways that they no longer achieve the greatest shareholder value by focusing on cigarettes. By making status quo products only a part of their commercial activities, and ideally a rapidly declining part over time, the incentives to maintain the *status quo* in the tobacco market would be considerably reduced. Cigarettes would no longer be the imperative for corporate survival they are now.

Quite how TTC could be offered such an escape route is one where there will no doubt be considerable debate as to what is appropriate. Some will no doubt argue that such policy foresight is not (yet) required as the industry still has considerable freedom within existing tobacco control regulations and is, as yet, fighting nothing like a desperate cornered animal. Others will object to the very idea since all firms are currently free to use existing tobacco profits to diversify their businesses into other non-tobacco markets to ensure corporate survival (as for example, BAT did in the 1970s when it moved into retailing with the acquisition of the Argos chain in the UK and Saks Fifth Avenue in the USA, and in the 1980s when it moved into financial services with the acquisition of Eagle Star, Allied Dunbar, and Farmers Group which made it the largest UK-based insurance group (British American Tobacco, 2015)). Whilst both views have merit, they also fail to recognise that the key point is to change the relative incentives faced by the companies in terms of their tobacco operations. The companies need to be given incentives to move away from their current focus on extraordinarily deadly cigarettes so that they accept the winding down of combustion-based tobacco products much like petrol companies moved to unleaded fuel. Governments could facilitate or even force this change, through measures such as tax differentials (Chaloupka, Sweanor, & Warner, 2015), tax credits, profit levies, banning of cartel enhancing tobacco company mergers, or more direct measures such as differential price controls, product licensing, or even striking a long-term legal bargain with the industry regarding its future strategic direction, investment and conduct. There are no doubt other possibilities that have yet to be thought of that could also serve to reduce the TTC focus on the maintenance of the cigarette business. Such polices should be aimed at removing the huge profit incentive companies achieve supplying, sustaining, and creating demand for cigarettes. Policy choices in this area would need to be mindful of the constraints operating in any particular market, such as the threat posed by illicit tobacco sales, and hence be selected accordingly. If there were to be a strong threat of increasing illicit sales, the fact is that measures to address corporate profitability of cigarettes need not significantly change retail prices, thereby not impacting the likelihood of consumers switching to illicit products. One such measure could be the imposition of a levy on cigarette profits which could not be passed on to consumers in the form of retail higher prices.