

TO: Distribution
FROM: G. C. Bible
SUBJECT: 1989-91 Three Year Plan

DATE: August 11, 1988

This memorandum sets out the guidelines for the 1989-91 Three Year Plan.

As in previous years, they contain three sections: a) international's objectives, b) issues we face worldwide, and c) the planning process.

A. PM INTERNATIONAL'S OBJECTIVES

These are our objectives for our 1989-91 Three Year Plan.

1. To achieve a minimum 15% annual growth rate in income from operations and in net income.
2. To add at least 5% each year to our volume and to build market share.
3. To achieve a return on assets of 13% by 1991.
4. To encourage new product innovation.
5. To achieve increased operating efficiencies in our plants and to become the low-cost producer within the industry without sacrificing quality leadership.
6. To freeze the headcount in our regional offices outside Asia and try to reduce it in other parts of the world.

B. ISSUES FACING PMI

We must constantly review and update our responses to the issues we face. Broadly speaking, I look at these as being in four areas -- Marketing, Operations, Corporate Affairs, and Information Systems. I will discuss each separately.

MARKETING

There are a number of issues to consider in this area, most of which relate to our brands, which is where I will start.

1. We must exploit the enormous potential of our other US heritage trademarks as well as Marlboro. Although I do not downplay the importance of local brands, US American blend trademarks generally do better both in volume and in profits.

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- o Parliament - Parliament is an example of a comparatively small brand establishing a solid international presence in a short space of time. Like Philip Morris, we have a consistent marketing approach which is proving successful in Taiwan, Turkey, and Japan. You should strive to get the brand going in other markets using the same approach.
- o Merit - With the shift to lower numbers, there should be more opportunities for Merit, and especially for Merit Ultra Lights. The brand is doing well in Italy, and has a good base in the Gulf. In your planning process, please think about opportunities for Merit very carefully.
- o Virginia Slims - This is a strong franchise which we are having trouble establishing in overseas markets. Only in Japan has Virginia Slims a reasonable base of business. This is disappointing because the female segment in numerous markets is important and growing. My conclusion is that we are doing something wrong. Please reflect on our approach to Virginia Slims to see what else we can do to get the brand firing in more markets.

c. Liggett brands

Lark, Chesterfield, and L&M, have proved to be invaluable. They are all growing, and I'm certain that we can still do much more with them.

- o Lark - Apart from Ecuador, Lark's strength is in Asia. My feeling is that we should keep our full weight behind exploiting it there and try to succeed with it elsewhere. I urge you to always keep it under consideration.
- o Chesterfield - Chesterfield is an excellent brand to be positioned with Marlboro against Camel, which is growing in some markets, and is of concern to us. With the buyout of the unexpired licences for Chesterfield in several of our key markets, we have regained control of this brand internationally. We have developed a worldwide campaign and are now well placed to launch it on a broad scale.
- o L&M is a tactical, price-fighting brand which has a reasonable base of business in Argentina, Germany, West Africa and Japan. While it does not have a consistent positioning in terms of price or image, it benefits from reasonable recognition which enhances the likelihood of a successful launch elsewhere. Also, we can produce it at quite low cost out of Brazil. Where price competition is an issue, don't overlook L&M in your plans.

d. Local brands

Although our first priority should be our US heritage trademarks, good opportunities exist for local brands tailored to individual market needs. Indeed, in several markets they are critical to maintaining the efficiency of plant operations because of the volume they generate. Local brands need to figure prominently, for example, in plans for Latin American markets and also for Australia, Finland, and Switzerland.

2. We need to turn up the marketing pressure on our competitors. For the most part, our brands have good momentum in good markets. Our American blend competitors are not as strong as we are. Their brands are generally not doing that well and they are strong only in pockets. I feel we have the upper hand. This presents us with an opportunity to gain long-term advantage over the competition by increasing the weight of our marketing efforts. You should consider ways that additional funds can be invested in marketing.

For each market you should plan specific programs directed at our competitors strongest brands. Your plans should state explicitly, for example, how we will respond to Kent, Lucky Strike, and Salem in Asian markets; Camel, Barclay, Winston, and Lucky Strike in Europe; Barclay in the Gulf; and strong local brands in Latin America.

3. We need to continue our program of new brand launches. This includes both line extensions of Marlboro and our international brands as well as free-standing launches. During the past three years our new launches have contributed about 25 billion units to our 1988 volume, and we need to keep up the rate of introductions in order to ensure continued volume growth. This is key to our plan. I strongly urge you to give this priority.

4. We need to focus more attention on point-of-sale. Sales, merchandising and promotional efforts are assuming greater importance, and our efforts at POS become critical to gaining volume and share. Your plans should spell out how we intend to improve our position at point-of-sale. This is one area where the plans have not been specific enough in the past.

5. We must be singleminded about getting price increases. While we have scored impressive successes with our volume gains in recent years, unit profitability lagged until 1987. This year we are making strong gains due both to volume and price. We need to ensure that this trend continues by achieving meaningful price increases which keep us ahead of cost inflation. However, we will continue to protect industry volumes best by regular, manageable increases, so your plans should reflect this approach.

6. We should continue to establish consumer data bases. Direct contact with the consumer is likely to become more important. I have been encouraged to see that many markets are establishing data bases of consumers and we should do more of this. In Europe, we are establishing a large central data center in Lausanne and this will make it easier for more markets to build data bases. As we gain experience in direct marketing, I am confident that we will find the investment we are making in this activity well worthwhile.

Corporate Affairs issues, too, are likely to require more direct access to our consumers, so this is an added reason to continue with our efforts to build data bases.

OPERATIONS

There has been a big focus on product quality in 1988 and we must keep this up. Your plans should spell out the actions we have agreed so far, with completion dates, and propose others that will continue to give us a quality edge. Wherever possible, your programs should have measurable criteria to help us monitor progress.

We must also continue to watch our costs and improve productivity. To balance the quality and cost objectives requires a well thought out operations plan. This should be issue oriented. Last year, some operations plans listed programs without putting them into a business context to explain their purpose. Your operations plan, therefore, should focus on the long term benefits to our business in terms of higher quality, improved productivity, lower cost or safety, for example.

As was the case last year, your plan should consider the following:

- o Equipment upgrading - We need to examine all primary, secondary, and warehousing equipment on a continuous basis and install later technology whenever it improves productivity.
- o Sourcing
- o Leaf purchasing and maintenance of blends
- o Plans for improvement in all essential benchmarks. Key here are yields, efficiencies, utilization, absenteeism, consumer complaints and wastage.
- o Plans for ensuring uncompromising focus on quality in tobacco, in our blends and in packaging and graphics
- o Inventory turnover
- o Release of dead assets
- o Constant reassessment of the applicability of state of the art technology to our business. Are we at the forefront and if not then why not?

- o Plans for fully exploiting our purchasing power with suppliers
- o Trade union relations, our weaknesses and how these will be overcome
- o A cost control program highlighting plans to achieve cost reductions

CORPORATE AFFAIRS

We have greatly increased the resources and attention given to corporate affairs issues and we have made headway in some areas, most notably in the opening of markets in Asia. Even so, there is an enormous amount still to do. Below are some issues which I feel strongly about.

1. We must deal with changing trade barriers. Of key importance here is the Single European Market, now scheduled for 1992. Two major issues, excise tax harmonization and Duty Free Sales, could have a profound impact on our business. We need to think creatively about these and look for ways to protect our volume and profits. Similarly the impact of China's annexation of Hong Kong in 1997 could have big implications for our business in Asia so this needs thoughtful planning too.

2. We must achieve price increases and resist tax increases. Our expertise in corporate affairs is central to PMI achieving its profit goals. Industry volumes are not growing much, so improved pricing is a must. Corporate affairs efforts have a direct impact on this issue and also on taxation, so we must plan to devote substantial resources to government relations on fiscal matters. Your plans should spell out the action programs for your principal markets on these.

3. We need to build coalitions to protect industry interests. Although, working alone, we have done a lot to protect our industry, we can achieve more with the help of allies. I therefore view the building of coalitions with groups which have similar interests to ours (e.g. growers, retailers, wholesalers) as a vital issue and one which needs addressing in your plans.

4. We must do much more on the ETS front. Environmental Tobacco Smoke remains a threat to our industry and we must step up our efforts to combat disinformation about it and to ensure that the public is fully-informed of the true facts concerning this issue. Your plans must address how you are going to achieve this. Here again, coalition-building is important.

5. We must instill the idea that corporate affairs is everyone's responsibility. I believe that we need active involvement on industry issues from many more people in our organization. We need to look for ways to train more employees to speak up about industry issues and to talk to people from the media, for

- o In looking at differences in the plans for 1989 and 1990, you should take the latest three year plans for these two years. Explain only the important differences.

As was the case last year, there will be a series of preliminary Plan Reviews before the final plans are sent to New York. The intention is to have an interchange of ideas while reviewing your underlying planning assumptions. These should take into account the issues raised in this memo, and others that you feel are important. At these review meetings, you should be prepared to discuss our performance against prior plan and differences between where you think this plan will come out, and earlier ones.

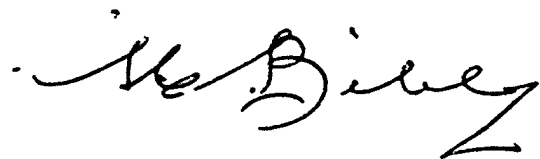
One full day will be allocated to each Region. The dates are:

October 22 - 26	Australia and Asia in Hong Kong
November 1	EEC in New York
November 2	EEMA in New York
November 7	Iberia in New York
November 8	Latin America in New York

Your final plan and supporting documents should be submitted to PMI's Planning department in New York by Wednesday, December 14th. This deadline date is important for me to meet my own deadlines.

Finally, I would just repeat a comment about your plans that I made last year. "They should be useful to you in running your businesses and they should explain how, when, where, and why results are going to be achieved in a succinct, well-reasoned, and readable manner."

If you have any questions about this year's planning process, don't hesitate to contact me, Martin Buss or Larry Rumble.



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