

June 22, 1984

TO: L. W. Hall, Jr.

FROM: E. J. Fackelman

SUBJECT: STRATEGIC RESEARCH RESPONSE

The following will provide you a perspective on the issue of "Strategic Research." This is in response to the memos from Marty Orlovsky, John Winebrenner and you (attached).

To pull this together, I received input from Ellen Monahan and Jim Gemma. I have organized the document into two sections:

- Summary Perspective
- Responses to Specific Questions

For the most part, there is little disagreement between Ellen, Jim, and me on the responses to specific questions. We all agree that John is not fully up to speed on what information we have in MDD and how we've attempted to use it.

With respect to the Summary Perspective, Jim, Ellen, and I may not necessarily agree on what the underlying issue is and what should be done about it. Therefore, this section largely reflects my point of view. I have attached Jim and Ellen's overall assessments as information. I do believe all of us, including Jerry Moore, need to convene to discuss this topic since it could have potential impact on the focus and structure of the department.

#### Summary Perspective:

After reviewing the questions John, Marty and you raised on Strategic Research, it seemed essential to provide a perspective beyond John's specific information requests. In doing so, I speculated on why the issue of strategic research continues to surface year after year in spite of a lot of hard work that gets done within MDD and a great deal of continuous discussion on the topic.

I believe there are some basic answers to why questions regarding strategic research continue to resurrect themselves.

- First of all, only MDD has assigned itself the full-time responsibility of addressing strategic issues. John's note is titled, "Strategic Research" and focuses most of its attention on information requests. This seems to indicate that the responsibility for conducting actionable strategic research rests solely within this department. I disagree. Strategic research only represents a portion of R. J. Reynolds Tobacco Company's strategic issues responsibility. I believe that the responsibility for understanding the market in which we

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compete, the sources that affect the market, and strategies designed to address these forces rests both with Brand Management and MDD. It's a joint responsibility that requires a close partnership between MDD and Brand. No one in Brand Management has served in a full-time strategic issues role. It has traditionally been a secondary responsibility of one of the Brand Directors. As such, it has not been given the attention it deserves. This is not an indictment of any of the Brand Directors. It merely reflects what they've been told are the primary and secondary accountabilities. What has happened over the years is that MDD has been proactive in identifying issues, suggesting research investigation and formulating strategic recommendations. While I'm proud of this, and feel we have made excellent company contributions in this area, it may not be the best arrangement for RJRT.

- I believe that the strategic research function to operate effectively needs to have a slightly different focus than other MDD research groups. It's one that anyone in line management has difficulty understanding. The work that has had substantial pay-off in a strategic sense has often started off as investigative. This is risky business from a traditional accountability standpoint since pay-offs are often hard to fully comprehend up front and there is a higher than average risk of failure. Yet this investigative thrust seems to be an essential ingredient to conducting successful, strategic research. The Younger Adult Smoker Analysis is a good example of investigative research. The issue of Younger Adult Smokers has been with Reynolds for years with endless white papers and trend reports written on the topic. However, until the recent Younger Adult Smoker Analysis was completed, the full importance of Younger Adult Smokers was never identified nor was a basic understanding of the long-term consumer dynamics of Younger Adult Smokers ever fully explained. I believe that had we asked up-front whether we should once again investigate the Younger Adult Smoker area we might not have been given support to do so. Perhaps everyone would have agreed that we knew all we needed to about Younger Adult Smokers having tracked their trend lines for nearly a decade. The point is that in the area of strategic research the lack of certain pay-off makes it difficult to establish priorities on topics because potential pay-offs only become obvious after considerable analysis and thinking takes place.
- I believe that both MDD and Brand have basic departmental issues to face if we are to come to grips with the issue of strategic responsibility. The issue itself suggests changes in departmental structure. The first decision that needs to be made is whether strategies or tactics should primarily drive the MDD or Brand organization. With regard to MDD, we are currently organized around individual end-users and data bases. As a result, this focuses the majority of our attention on tactical rather than strategic, multi-brand issues. Being end-user and switching data base structured has the effect of scattering strategic information around the department. Sales analysis is in one place, profile and switcher data is in another, wants and perceptions in yet another. This makes the development of integrated learning difficult because control of the data bases doesn't reside within one strategic functional group. As a result, those in charge of data-base management have to trade-off the requests, direction and

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timing of end-users desiring tactical information and those requiring strategic information. Additionally, by scattering the data bases around we have propagated a series of information-based reports and have issued management fewer strategic/multi-brand studies. If we want to change this we need to take a very hard look at the mission and accountabilities of the four MDD groups. We need to decide how we want to focus each group without regard for current structure. Of course the decision to do this will depend on our decision of whether the primary thrust of MDD should be strategic or tactical in nature.

Needless to say, this document will not serve to be a definitive response to what I believe to be some of the underlying questions raised in the strategic research memo from John. In my opinion both MDD and Brand need to engage in some depth soul searching regarding this topic. One option is to continue to operate as we currently are, focusing the majority of our attention on tactical issues and information reporting. Or we can choose to change the focus of our efforts and become more heavily committed to strategic issues. Doing this may require MDD and Brand to reorganize their departments and assign additional personnel strategic issues responsibilities. Only by making these basic decisions do I believe we will begin to address the underlying problem which continues to trigger the strategic research challenge.

#### Responses To Specific Questions

1. "Have we identified all of the issues? (LWH)" The answer to this question is that we have not. In fact, John's note did not reference some of the largest issues currently facing the Company:

- Pricing
- Younger Adult Smokers
- Distribution
- Special Markets

2. "To what extent can we address these issues through our existing systems? (LWH)"

a. "Much of our Strategic Research is too general and too unrelated to the cigarette market to be of specific use to us. (JTW)"

- Each year we fold available learning into the Future Lifestyles presentation. This learning comes from a broad variety of sources including Yankelovich, VALS, the Naisbitt Group, input from our suppliers and our own scanning for trends. This review eliminates the necessity for our end-users to do this individually. It's purpose is to provide a consolidated perspective of consumer and external forces and identify their broad impact on RJRT.

As you know, MDD was instrumental in suggesting and designing a system to apply this type of research to individual brand needs via the Established Brands Positioning Process. This system takes broad concepts like upward striving and determines their specific application to individual brand families.

b. "Much of our tactical research is very brand specific. (JTW)"

-- In the case of TRACKER and other ongoing consumer information systems, their purpose has been to capture key trend data which has been deemed essential to monitor the health of our brands. It has been primarily used to understand what has happened historically in order to assist in predicting future trends. A good example is the Younger Adult Smoker issue that is facing RJR. Without the TRACKER data base, it would not have been possible to identify the Company's weakness and determine its likely affect on future company performance. It may be true that we are not gathering all information we need in TRACKER or in our other systems, but the solution to the problem is not in designing mega-database systems. The solution is to identify the issues which need to be addressed. This is a joint responsibility of Brand Marketing and MDD.

c. "I often feel that we do not have adequate consumer tracking data to give a diagnostic understanding of many phenomenon and changes that are occurring in the marketplace. (JTW)"

-- "Smokers are trending toward 100mm styles and away from 85mm styles."

John is correct, we don't know the underlying reasons for this phenomenon. However, we do have reasonable hypotheses such as the need for value, the disproportionate growth of female smokers, etc. If this is a major issue, we can launch a program designed to answer the question.

-- "Smokers are trending away from low tar brands, specifically Moderation and Concerned segment brands."

Again, we don't have any definitive reasons why this is occurring. However, we do have some sound theories. The most reasonable is the proliferation of lower tar line extensions of brands in other segments. This has reduced the supply of switchers from other segment brands by allowing smokers to switch to a lower tar level within their brand family. Here again, we could launch a diagnostic program if this issue were deemed sufficiently important.

-- "Social pressures are bearing down hard on smokers these days, but we don't really know how these pressures impact on their smoking habits in terms of where, when and how much they smoke."

We do have a good understanding of this issue based on two years of studies designed to examine these issues. Additionally, more tactical research, which Brand is not aware of, has been completed to support Public Affairs and Public Issues. Of course, each year

as in the past, we modify the Smoking Attitudes Study to cover new or unresolved issues.

-- "I would suggest we develop an ongoing monitor of smoker attitudes and behavior covering a large sample of smokers. (JTW)"

- "Smokers' attitudes toward smoking and how they are changing" -- We have a large base of information on the topic from the Smoking Attitudes Studies.
- "What type of cigarettes (100mm vs. 85mm, box vs. soft pack, menthol vs. NM) are preferred by smokers and their reasons for this preference" -- We have some information on this topic. This area can certainly be addressed via custom research if deemed important.
- How important is tar and nicotine in the selection of a cigarette brand? -- This issue varies by smoker, of course. Some smokers are driven by T&N considerations and this decides their choice of a concerned or moderation brand. For other smokers, more traditional user or product imagery is of primary importance and T&N considerations are of secondary importance. All smokers of course are T&N conscious in the sense that this determines level of strength and taste impact. Modifying their traditional T&N tastes requires a motivation for change. For most smokers, this has been the alleged health concerns.
- What does quality mean to a smoker? -- This issue was the focus of a study completed a few years ago by the Consumer Research Group.
- What does value mean to a smoker? -- Strategic Research completed a conceptual review of this topic in the 1983 External Influences Study. Additionally, some information is available from individual brand work completed by CENTURY, and DORAL and from the 1983 Segment Description Study. If the topic is worth further explanation, we could launch a program to pull all available information together.
- What is the relative importance of image versus product factors in selecting a cigarette brand? -- We attempted to resolve this in the 1979 Segmentation Study. That study via conjoint analysis, traded-off image versus product factors. The attempt was unsuccessful because of smokers' reluctance to admit their desire for imagery. More recent research -- the 1981 and 1983 Segment Description Studies and individual brand research studies -- have led us to believe that both factors are important, relevant and non-separable. For a brand to be successful, both the imagery and the product must be consistent. Both are necessary for success.

With respect to John's suggestion of an ongoing smoker monitor, this has the same problems associated with it that any ongoing system has -- what are the issues. We would be better off to

decide on a hierarchy of issues than to launch yet another large data-base collection device. All of the individual questions raised by John can best be answered with available information or incorporated into custom research programs.

- d. "Our current NFO and Tracker systems report purchase behavior and attitudes on a twice-a-year basis (JTW)."

Tracker data is collected and utilized on an ongoing, continuous basis. Although some tracking data is reported twice a year, a variety of behavioral data is reported more frequently. Monthly measures of awareness, trial and purchase are provided in the Consumer Alert System. These measures detect changes that are likely to occur in response to current marketing events. Other information, such as usual brand share, and switching is reported less frequently because change is not likely to occur as quickly. Specifically, the following reports serve to provide periodic updates of key information:

-- Monthly Alert reports provide rolling quarter trend data on awareness, trial and usage (both regular as well as occasional) for each Brand. This trend information is combined with our knowledge of in-market activities (monthly media spending patterns, promotions, drive periods, etc.). The result is an ongoing study of consumer performance and factors influencing it. This information is part of the State of the Brand reports discussed earlier.

-- Brand Summary Reports provide bi-annual reference documents to Brand and Agency end-users. The intent in using interims of six months is to ensure that "real" differences or changes are identified as opposed to those resulting from marketplace or statistical aberrations.

-- Plans are currently underway to provide share of smoker information among key demographic subgroups on a quarterly basis instead of just every six months in order to provide more insight on how effective our marketing efforts are in impacting target smokers.

-- Ad hoc analyses are also possible. The most recent example is the business analysis being prepared on Special Markets. It will incorporate consumer data which was collected over the entire year, and is now being summarized in response to Brand Marketing's request.

The current Tracker system is not restricted to a specific reporting schedule. Its continuous nature allows us to report results on any schedule that suits the needs of end-users.

- e. "I would like to suggest that we develop an ongoing tracking system using a substantial panel of smokers. . .this type of system could give us a great deal of insight into the following areas (JTW):"

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-- The regularity and frequency of brand usage and switching

These data can be obtained from existing sources, i.e., Tracker and NFO, in which we monitor rate per day and length of time with usual brand.

-- The impact of promotions as a cause of switching and conversion

Substantial information on the impact of various promotion vehicles is available from Promotion Research, especially as it relates to trial and conversion. We are also creating a promotion development and evaluation process that will allow us to measure the impact of promotions on these key variables prior to national introduction.

-- The level and trend in occasional vs. regular usage of a brand

This information is reported every month in the Consumer Alert System.

-- The patterns of using second choice brands and reasons for selecting a second choice brand

A recent report on occasional usage pattern covered these and other similar issues. These kinds of studies can be repeated using methods other than a diary panel if the need is great enough.

The development of a consumer diary panel on cigarettes should be an extremely complex and expensive proposition. Because cigarettes are an individual purchase and not a purchase by the primary grocery shopper, combined with the daily nature of cigarette buying behavior, the accuracy and validity of a consumer diary would be very difficult to judge. This would be especially true among the key target groups of younger adult smokers.

3. "What are implications regarding cost/benefit relationships? (LWH)"

There is probably no need to dramatically expand our dollar outlay to answer the questions John has asked. Many of these answers can be provided through manipulation or consolidation of existing in-house information. The largest cost will be in manpower. Before we commit substantial MDD time, it would seem best that the Senior Managers of MDD sit down with Marty to discuss the broader questions and issues which motivated John's memo.

4. "What are the implications regarding MDD responsibility? (LWH)"

With respect to this question, the senior MDD managers need to convene to discuss area responsibility. In some cases, we are issuing redundant reports (e.g., Younger Adult Smokers, Black Smokers). In other cases, we may have misplaced responsibility (e.g., support to R&D Bio-behavioral and

Public Issues within Strategic Research). Finally, we need to ensure that the responsibility for the management of data-bases is properly placed within MDD. The decision on where they belong should be based on what we decide the primary thrust of the Department to be.

5. "What are the implications regarding manpower needs? (LWH)"

At this time, it is almost impossible to address this issue. However, if we eliminate MDD redundancy, and if we can agree with Brand that the responsibility for strategy is a joint one, then MDD should be able to meet everyone's needs within our existing headcount allocation. This may not be true for Brand.

*Ernie*

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