

Plain packaging: just plain stupid

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On 31 May 2008, the UK government began a new consultation process on the future of tobacco control. While most of the proposed regulations have been trailed for some time, one suggestion came as a bit of a surprise: the potential introduction of plain packaging for cigarette packs, a proposition that could threaten profitability in the tobacco industry.

The consultation, the British department of health (DoH) says, is the first step in developing a new national tobacco control strategy. In 2007, the Cancer Reform Strategy announced the UK government's intention to consult on the next steps in tobacco control and its continued efforts to regulate tobacco products, and to consult with stakeholders "on measures to reduce the significant harm to health caused by smoking for those who are addicted to nicotine and not able to quit altogether". The consultation, which aims to further reduce smoking prevalence in Britain, particularly among young people, follows other recent measures, such as increasing the legal age for purchasing tobacco from 16 to 18, which went into effect in October 2007, and the introduction of pictorial health warnings that will become mandatory on 1 October 2008.

"The future of tobacco control", as the consultation document is titled, focuses on four measures to restrict the industry. It stipulates a minimum pack size of twenty cigarettes, thus eliminating the ten-stick packs currently available in the UK; it requires a complete ban on the retail visibility of cigarette packs, with the product essentially kept under the counter; in addition, it foresees additional restrictions on cigarette vending machines to reduce youth access. While these three proposed measures mirror steps taken by other countries – France has also banned packs of ten cigarettes and Canada has implemented display bans for cigarettes at the point of sale – or are rather insignificant in terms of sales volume – cigarette vending machines account for only one per cent of cigarette sales in the UK –, it is the fourth proposition that is causing a bit of a stir: the introduction of plain, or generic, packaging for cigarettes, in order to make them less appealing to young people and hence reduce the uptake of smoking, meaning that "all the attractive, promotional aspects of tobacco packages are removed and the appearance of all tobacco packs on the market is standardised", as the proposal puts it. Except for the brand name, which would be required to be written in a standard typeface, colour and size, all other trademarks, logos, colour schemes and graphics would be prohibited.

"The package itself would be required to be plain coloured (such as white or plain cardboard) and to display only the product content information, consumer information and health warnings required under the law." As potential positive effects of generic packaging, the proposal cites a further "denormalisation" of tobacco products and a change of the social acceptability of tobacco use, sending out a "strong message about the seriousness of the harmful effects of tobacco". The document also states plain packaging could reduce the "misleading differences between various tobacco products, such as the common use of colour to represent different cigarette 'strengths'", and it would also break the link between past advertising campaigns

prior to the banning of advertising in 2003 and the “continued advertising presented by the package”.

Unlikely but threatening

Tobacco analysts unanimously agree that the introduction of plain cigarette packaging in the UK is unlikely in the near term for various reasons, but they also paint a sinister picture for the market if the proposal does indeed become a reality. Not only would a standardisation of cigarette packaging drive down pricing and put an end to the appeal of premium cigarettes, which carry higher profit margins, but it would also lead to a rise in illicit cigarette trade. What analysts actually view as a greater threat with far-reaching implications is that the UK’s proposal, as the authors of the consultation document themselves mention as a potential disadvantage, could become a precedent to be imitated, not only in other geographical markets, but also across the entire fast moving consumer goods’ (FMCG) industry, where tobacco products are usually grouped. As for the global tobacco industry, the seminal legislation could pose a real risk to profitability in the future.

In markets such as the United Kingdom, where the marketing of tobacco products has become severely restricted and the advertising of these products has long been banned, the pack itself has become the last bastion for cigarette manufacturers to communicate with their customers, a “key promotional vehicle” for the industry, as the consultation paper puts it. Thus, an increasing focus has been put on the ever more elaborate design of cigarette boxes. Exclusive packaging is an instrument to communicate brand image and differentiate premium, high-priced brands from value cigarettes; while the cost of production is roughly the same for both and, according to analysts, the difference in quality is barely perceptible, the profit margin of premium brands is considerably higher than that of low-priced cigarettes. Plain packaging, says tobacco analyst Adam Spielman of Citigroup, would level the playing field, making premium brands less attractive to smokers, and would lead to a rapid worsening of the downtrading trend, which has been going on for years in the UK, far and away the most expensive country in Europe for smokers.

Over time, he argues, this would hurt profitability considerably, more than the other regulations put forth in the consultation – they could be countered through higher prices, whereas plain packaging would affect mix by doing away with the perceived premium-brand consumer value (see also interview on page 26). According to analysts from Morgan Stanley, if generic packaging becomes a legal requirement in the UK, not only could it have a domino effect on other markets, but it could also have a materially adverse impact on cigarette brand equity and, unlike other regulations, commoditise the overall category, which could result in considerably reduced profits.

Protecting intellectual property

Analysts expect a strong legal challenge from cigarette manufacturers should plain packaging become law in the UK. The idea of standardised packaging for cigarettes is not new – in 1994, the measure was considered in Canada, but was dismissed because of intellectual property rights. This precedent currently provides comfort for cigarette manufacturers, including UK market leader Imperial, which has a market share of roughly 46 per cent and generates about 25 per cent of its group profits in its homeland. The company would be hit worst by generic packaging legislation. “We believe that we have a right to differentiate our brands from those of our competitors

and we are completely opposed to plain packaging based on a number of legal concepts, including those covering intellectual property rights and commercial rights,” Bob Dyrbus, Imperial Tobacco’s finance director, said at JP Morgan’s recent global tobacco conference.

As members of the Paris Convention for Protection of Industrial Property, both Canada and the UK have specific legal obligations to protect industrial property, including any acts that create trademark “confusion”, for example through almost identical packaging. The General Agreement on Tariffs & Trade (GATT), to which both countries are also signatories, however, allows health considerations to limit trademark rights as long as health objectives cannot be met any other way. Back in 1994, Canada’s department of health failed to prove that generic cigarette packaging cuts tobacco consumption, and industry hopes are now built on the fact that the UK DoH consultation paper admits that the research evidence regarding the impact of plain packaging on cigarette consumption is “speculative”. Nevertheless, says Charles Manso de Zuniga, tobacco analyst at Dresdner Kleinwort, “this does feel like a Catch-22 situation, that is: how does one satisfy the burden of proof unless there is a market with plain packaging?” Acknowledging that the ramifications are huge, he adds: “We have no way of knowing whether the legal arguments that successfully blocked the introduction of plain packaging in Canada fourteen years ago will still prove impermeable today.”

Unintentional effects

Intellectual property issues aside, the introduction of generic packaging for cigarettes in the UK would bring about serious, unintended consequences. Lacking conventional package branding which contributes to consumer recognition, cigarette contraband and counterfeiting would probably increase. Moreover, as smokers like their brands, “proper” cigarette packs purchased in countries outside the UK – where they have the additional advantage of being much cheaper – would likely become more desirable, thus boosting already significant cross-border smuggling. This, together with the expected down-trading trend, would lead to a decline in excise tax revenue for the British government.

Both analysts and the consultation paper authors doubt whether plain packaging would have the desired effect of reducing the uptake of smoking among young people – starting to smoke “could be seen as rebellious”, the department of health concedes. Jonathan Fell, research analyst at Deutsche Bank, is confident that the proposal will go nowhere: “We suspect that on closer consideration, the department of health might realise what a can of worms plain packaging might open up.” The proposed policy looks more like a weapon to attack the tobacco industry than a real attempt to reduce tobacco consumption, he continues, and it raises many questions, such as why do young people try illegal drugs, which are not sold in branded packs? “Race to the bottom”

Just how unlikely is the introduction of generic tobacco packaging? The proposal is eerily reminiscent of how much of industry regulation has come to pass, namely, once it has been put on the table, it never really goes away until one country becomes bold enough to implement it and then others soon follow suit. “There has been an almost perverse ‘race to the bottom’ in many markets to institute the most onerous possible tobacco regulations, for example, large pictorial health warnings in Brazil,” notes

David Adelman, tobacco analyst at Morgan Stanley. “If plain packaging were adopted in the UK, some other nations would most likely mandate [it] as well.”

The topic of standardised packaging of cigarettes has indeed been under recent discussion. Trinidad and Tobacco considered it, and in March 2008, researchers at the School of Public Health in Sydney, Australia, published a study, “The case for the plain packaging of tobacco products”, in which they found that, despite daunting images and warnings on tobacco products, brand imagery and colourful packs distract and reduce the impact of health warnings. Plain packaging, the authors of the study argued, would be perceived as dull by young people and hence would considerably reduce the appeal of cigarettes.

In the UK, cigarette manufacturers are reluctant to talk about generic packaging for their products as long as the three-month public consultation process is still open. “The department of health’s document seeks views on the potential for plain packaging on all tobacco products. In the absence of a specific proposal, it is difficult to identify precisely what such a measure would entail and we would expect a genuine consultation in this area,” explained a spokesperson for the UK’s Tobacco Manufacturers’ Association. British tobacco companies and other interested parties have until 8 September 2008 to submit their responses to the 17 questions contained in the consultation paper to the department of health, which says it will consider all comments carefully and then release a summary by December, with rulings thereafter.

Display ban likely

As was previously mentioned, the consultation paper also focuses on other aspects of future tobacco regulation, including the proposed banning of the retail display of tobacco products at the point of sale and doing away with packs of ten cigarettes. Analysts question the effectiveness of the first measure, claiming that the impact of display bans on tobacco consumption has been minimal, as studies from Canada show. However, some experts believe a ban on retail display, as has recently been legislated in the Republic of Ireland and will be implemented in July 2009, is the most likely restriction from the consultation to become reality.

Bob Dyrbus from Imperial Tobacco suggests that stricter enforcement of the current under-age laws, coupled with more resources for trading standards to tackle illegal selling, would be a much more effective measure. Packs of less than 20 cigarettes, he adds, should not be banned as they allow adult smokers to control their daily consumption and expenditure. He also points out that a ban on small packs may encourage smokers to seek cheaper 20-packs through illicit trade channels.

Approaching harm reduction

Let’s remember that the British government is currently only seeking general feedback and that specific proposals have not yet been considered. And though it is the vigorously debated proposed restrictions in the consultation paper which quickly catch the eye, the document contains a potentially positive aspect for the tobacco industry. The department of health intends to “help those who cannot quit” by “considering the potential of a harm reduction approach in tobacco control to help people whose addiction to nicotine makes it extremely difficult to quit altogether”. Acknowledging that smoking’s impact on an individual’s health is largely unrelated to nicotine, but rather to emissions from smoking tobacco, particularly the tar and

carbon monoxide, the paper suggests that harm reduction initiatives should be made more widely and easily available to smokers as alternatives to cigarettes.

The paper also agrees with the recent findings by the EU's expert scientific advisory group on Swedish oral tobacco, snus, according to which "the use of snus as a harm reduction option deserves consideration", if it can provide "some of the smokers who will not otherwise quit with a less hazardous source of nicotine". Though the paper mentions potentially reduced exposure products (PREPs) in the context of harm reduction, it rules out any relative health claims for these products based on a lack of evidence of their long-term impact on health. Yet analysts find this phase of the consultation process encouraging. Says Deutsche Bank's Jonathan Fell: "The key point is that this is the first time that an open debate on harm reduction has formally been invited by the government, and we regard this as a positive step."

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