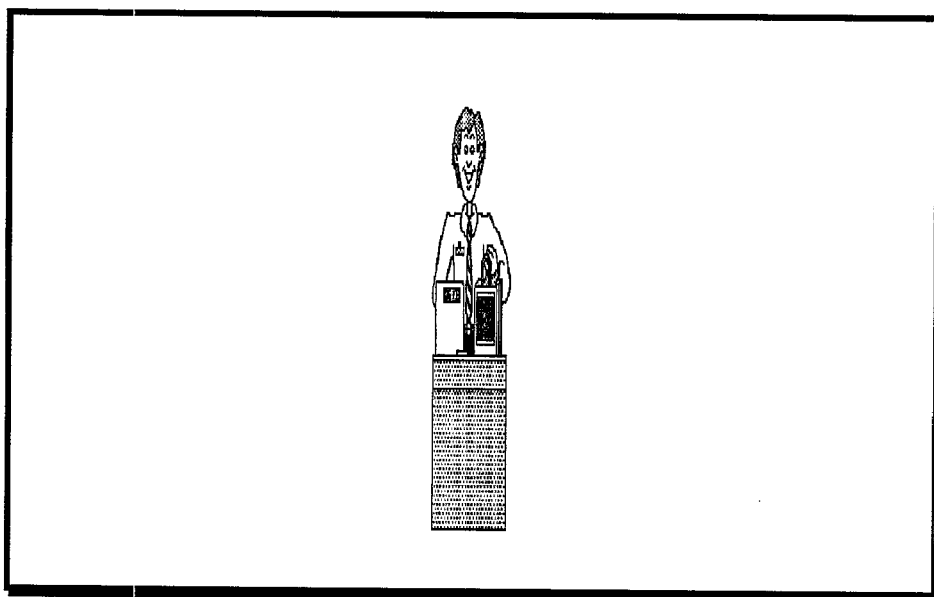


MANAGING YOUR TOBACCO CATEGORY



Participant Reference Guide

**USA PHILIP
MORRIS**

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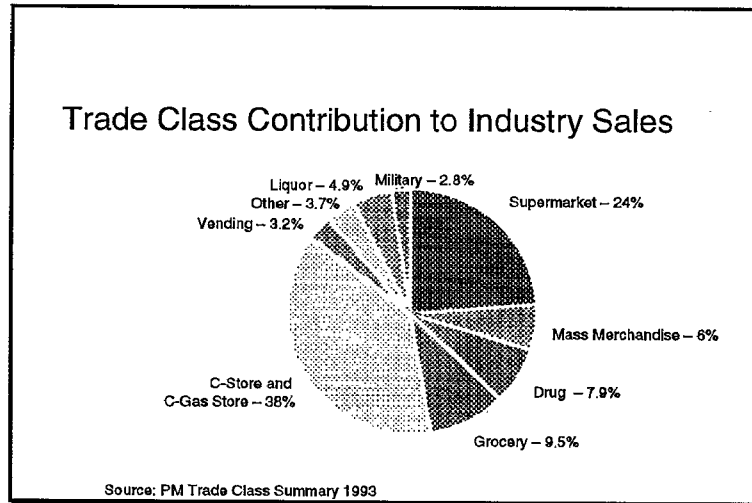
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MANAGING YOUR TOBACCO CATEGORY

I. What Does Tobacco Do For Your Store

Fifty million Americans buy 500 billion cigarettes a year. And they spend more than \$30 billion to do it. Many of these cigarettes—over 38%—are sold in convenience stores.

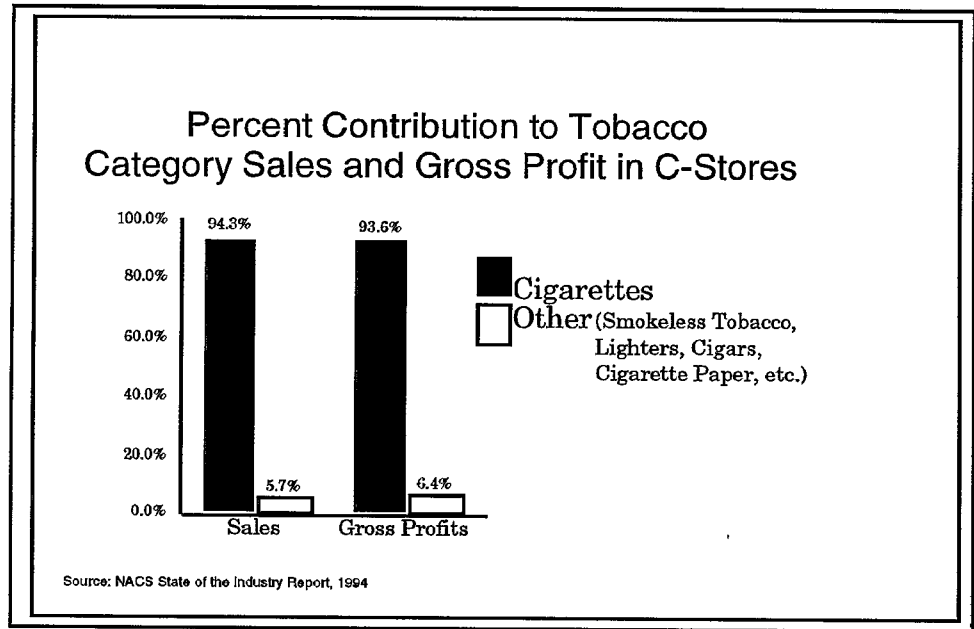


NACS research tells us tobacco contributes about 28% of sales and 21% of gross profits in convenience stores.

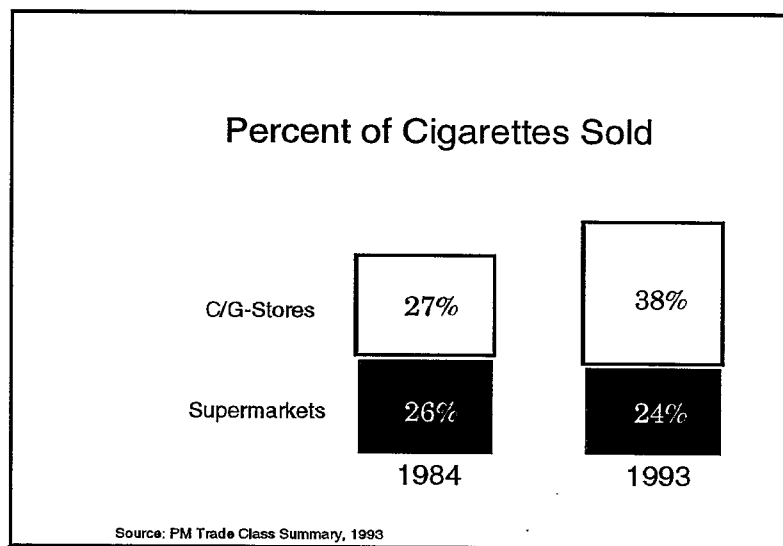
C-store Inside Sales	Percent Of:	
	Sales	Gross Profit
Tobacco	27.9%	20.7%
Food Service	13.9	19.8
Beer	13.2	9.7
Soft drinks	9.5	9.6
Milk & Milk Products	4.8	3.7
Candy & Gum	4.8	6.5
Packaged salted snacks	4.4	4.9
Grocery	3.9	4.3
Publications	3.1	2.2
All Other	13.6	14.8

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Of the entire tobacco category, about 94% of its sales and Gross Profits are from cigarettes.



Data shows that an increasing number of consumers are spending their cigarette money in convenience stores—38% today, up from 27% in 1984—while fewer are buying in supermarkets.



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Cigarettes come out even further ahead of the next two most profitable categories, beer and soft drinks, when you look at storage costs. Cigarettes are low-bulk items. Because they take up less space and don't require refrigeration, you see considerably more direct profit.

Though rebates and merchandising allowances should not be the dominant influence in managing the cigarette department, merchandising programs are available for displaying and promoting cigarette brands. Philip Morris' Retail Masters Program is an example. Merchandising programs vary from manufacturer to manufacturer, so you'll want to discuss details with your local tobacco company rep.

The real key to optimum cigarette profitability is *effective management of your department*. There are five basic category management principles:

- Prominently display the leading brands.
- Manage the overall number of displays and avoid unproductive displays.
- Keep inventory levels in proportion with sales, and be sure your *visible inventory* also reflects this proportion.
- Use cigarette promotions and advertising to build store traffic.
- **If you have price sensitive shoppers, offer a private label or promote a discount brand.**

TEST YOURSELF: WHAT DOES TOBACCO DO FOR YOUR STORE?

1. The average C-store sells a number of tobacco related products. About what percentage of the tobacco category sales dollars do cigarettes account for?
 - a. 53%
 - b. 94%
 - c. 85%
 - d. 25%

2. Of the following categories, number in order of in-store sales and profits in C-stores.
 - a. Milk and Milk products
 - b. Beer
 - c. Tobacco
 - d. Candy & gum
 - e. Food service
 - f. Soft Drinks

3. Of all the cigarettes sold in the United States, what percentage is sold through convenience stores?
 - a. 13%
 - b. 25%
 - c. 38%
 - d. 50%

4. Complete the following.
 - a. On an industry basis, the tobacco category accounts for:
 - What percentage of C-store sales? ____%
 - What percentage of C-store profits? ____%
 - b. In your store, the tobacco category accounts for:
 - What percentage of store sales? _____%
 - What percentage of store profits? ____ %

5. When comparing cigarette sales trends in supermarkets with convenience stores, what are the trends for these two trade classes?

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6. List the five basic Cigarette Category management principles:

1. _____
2. _____
3. _____
4. _____
5. _____

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II. Product Selection

Product selection is one of the most important decisions of managing the tobacco category. There are over 400 different brand/packings. Choosing the right brands and packings will put you on the right track to exploiting the big profits in this category. There are a number of different things you need to know:

- The **six major tobacco companies**: Listed here with their national market share breakdown by A.C. Nielsen:

Philip Morris	48%
R.J. Reynolds	28%
Brown & Williamson	11%
Lorillard	6%
American Tobacco	5%
Liggett & Myers	2%

Of course, local market share figures may vary with some brands and packings—and that's where your knowledge and your tobacco rep's knowledge come into play. *You need to analyze your market and allocate cigarette brands and packings according to their popularity and movement in your market area.* Your local tobacco representative can be of valuable assistance in helping you make this analysis.

- The **different price tiers**: There are three tiers:

- | |
|---|
| <ul style="list-style-type: none">• Premium brands• Discount brands• Deep discount brands |
|---|

Premium brands, or full margin brands, will generally produce maximum penny profits. Your cost from the distributor will generally be about \$3.00 less per carton for discount brands than for premium brands. Deep discount brands are generally about \$5.00 less per carton. You need to determine the mix of price tiers for your market that will give you the best return on inventory investment, detailed later in this Reference Guide.

- **Customer demographics:** Demographics include age, race, sex, education, income, and family size. How you allocate your inventory dollars will be influenced by the popularity of the different brands and price segments among your customers, who can be grouped demographically.

Here are three market examples of how demographics could predict customer buying preferences:

In an urban white collar market where the customer profile reflects an average household of 1-2 persons with above average income and education, Premium cigarette brands could be preferred.

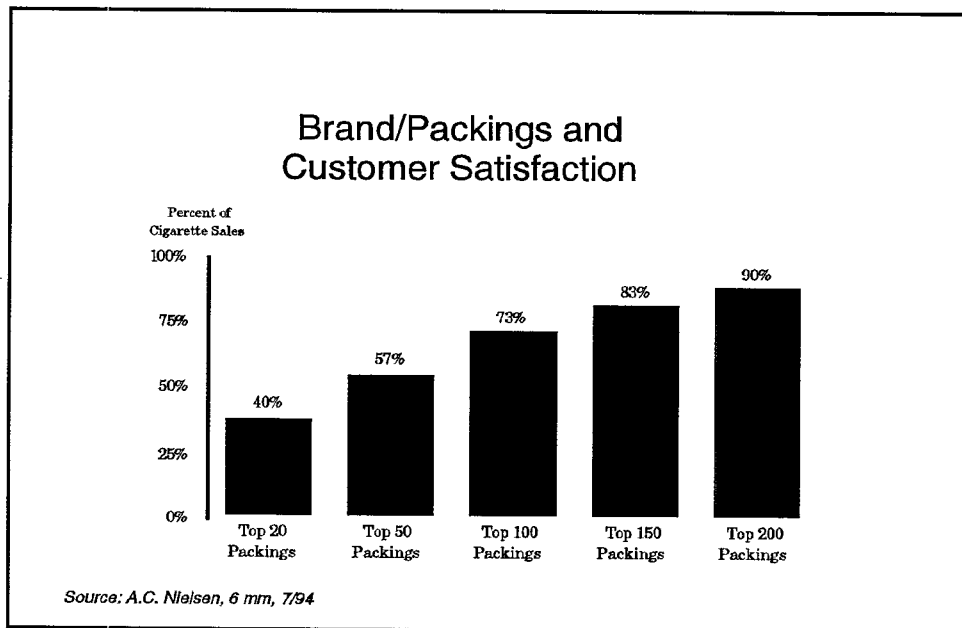
In a typically urban blue collar market, households of 1-2 people, with average income under \$15,000 and education high school or below, Menthol cigarettes may be favored.

Homeowners in a suburban market with higher income and education levels and workers in management and professional occupations could prefer Premium brands. In the same suburban market example blue collar customers as homeowners with moderate incomes and elementary to high school education may prefer Discount brands.

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- **Objectives for customer satisfaction** will influence the brand packings you carry. You want to satisfy all your customer requests, if possible.

Research shows that you can satisfy 90% of customer demand by carrying 200 packings, with the top 20 brand packings representing 40% of your cigarette business. (In some markets, specifically in c-stores, the top 20 brand packings can account for over 50% of the store's cigarette sales.) However, this can vary from market to market, either up or down; your cigarette sales rep or your candy and tobacco distributor can help you determine that. The local wholesaler or supplier for your store knows the local markets and can help you set up the best product mix for your store.



- **Requests from regular customers:** You'll probably want to carry their brands.

The key to brand selection is to choose brands that are locally popular and that match up demographically in your market.

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TEST YOURSELF: PRODUCT SELECTION

1. List the 10 top-selling brand/packings in your market area.

- | | |
|----------|-----------|
| 1. _____ | 6. _____ |
| 2. _____ | 7. _____ |
| 3. _____ | 8. _____ |
| 4. _____ | 9. _____ |
| 5. _____ | 10. _____ |

2. What trends do you see in cigarettes in your store and your market?

3. Answer the following.

a. What are the three cigarette pricing tiers?

- | |
|----------|
| 1. _____ |
| 2. _____ |
| 3. _____ |

b. What are the approximate price differences per carton between each price tier?

4. List the percentage of cigarette sales by manufacturer for your store.

Philip Morris _____%	Lorillard _____%
R.J. Reynolds _____%	American Tobacco _____%
Brown & Williamson _____%	Liggett & Myers _____%

III. Merchandising

Once you've determined the brands to carry for your customers, you need to merchandise them properly. A cigarette department is successful when it (1) takes advantage of new and different product offerings and (2) follows the five basic category management principles outlined in Chapter I.

(1) New programs, supported by manufacturers' advertising and promotion, are designed to generate interest and excitement and bring customers into your store. (2) The merchandising principles we talked about are built on proven practices that generate sales and profits. These five principles are:

Principle #1. • Prominently display the leading brands. Place high velocity brands in the best locations. Displays that contain high turn brands such as Marlboro should be located in the best location relative to the point of sale—the prime checkout position, or “hot spot,” for your fastest selling products. According to some experts, at least one-half of all purchases in convenience stores are impulse items, so placement of your most profitable products is very important. Just as your inventory is an investment, so is your prime checkout position, and you want the best possible return from that space.

Principle #2. • Manage the overall number of displays and avoid placing unproductive cigarette displays. When we say “manage the overall number of displays,” we mean two things: first, place only as many displays as you need to make your display space profitable. From industry research done by Bain & Co., the optimum number of displays for peak profitability is six. This number can vary as counter space differs from store to store. Second, stock your displays properly—clean, full and organized, with appropriate header cards. Customers are more likely to notice, be attracted, and buy on impulse.

Avoid placing cigarette displays that contain slow turn brands. They are *unprofitable* and you should consider eliminating them from the display mix.

Another important issue is counter clutter, an unproductive condition for your front end counter space, that costs you money because it—

- Encourages pilferage.
- Generates inventory excess.

- Reduces impulse purchases on popular items that are obstructed.
- Requires you to spend more time taking inventory.
- Creates a negative perception about product quality.
- When you reduce counter clutter:
 - Pilferage is likely reduced because of increased visibility.
 - Carrying costs are lowered because of reduced low turn inventory.
 - Turnover of displayed premium product is increased.
 - The end result is improved profitability.

Effective merchandising can be facilitated by storing and fixturing product properly. For packs, self-service or non-self-service tobacco company or store-owned fixtures are available. Fixture size should accommodate at least 10 packs, or one carton, per brand packing to eliminate loose stock. Contact your tobacco sales rep when you need any of these fixtures. (And when you're placing them, think about traffic flow in your store.) Permanent counter displays also serve as fixtures for holding cigarette stock. Whether you set up your cigarette packs in the pack racks alphabetically, by company, or by movement, keep two rules of thumb in mind:

- The fastest selling brands must be the most easily accessible.
- Your organization system must make it easy for sales clerks to find all brand packings quickly, so customers aren't kept waiting.

Principle #3. • Keep inventory levels in proportion to sales -- both visible and nonvisible inventory. Latest *C-Store News* research shows that full margin product represents nearly 80% of sales in convenience outlets. Visible inventory should reflect this ratio.

Principle #4. • Use cigarette promotions and advertising to build store traffic. National programs like *Marlboro's Adventure Team* and *Country Store* offered big retail promotions that created retail excitement and grew store sales and profits.

Principle #5. • If you have price sensitive shoppers, offer a private label or promote a Discount brand. Premium brands yield the highest profit margins, but some of your shoppers may look to stretch their dollars by buying Discount and Deep Discount brands. Implement this strategy only if your market conditions can truly support such action. Be mindful of some real business consequences of offering these brands to your shoppers:

- Decline in Premium brand sales -- Loyal Premium brand smokers switching to a less expensive brand may result in less cash revenue for your operation and possibly fewer Gross Margin Dollars to take to the bank. Is price promoting using a private label or Discount brand worth this risk?
- Increase in value shoppers in your store -- Attracting too many "value shoppers" to your store could result in problems you never imagined. Many of these bargain hunters lack the spending power of premium shoppers and most only look for the best deals. This situation may lead to an increase in your operating expenses (labor, shrink, inventory holding costs, etc.) without generating sufficient Gross Margin Dollars from sales to offset the added cost. Is price promoting using a private label or your Discount brands worth the potential added cost?
- Decline in Premium shopper base-- Your Premium shoppers may begin to feel overwhelmed with your new store direction towards value shoppers and may take their business elsewhere. Remember your client base shops at your store mostly for convenience. Is price promoting using your Discount brands worth potentially losing some of your most loyal shoppers?

TEST YOURSELF: MERCHANDISING

One key merchandising principle is to display the leading brands prominently. You want to place high velocity brands in the best locations.

- List and count by brand family the number of premium packs that are on display in your store.

<u>Premium Brand</u>	<u># Packs</u>	<u>Premium Brands</u>	<u># Packs</u>

List and count by brand family the number of discount packs that are on display in your store.

<u>Discount Brand</u>	<u># Packs</u>	<u>Discount Brands</u>	<u># Packs</u>

Category Principle #2 : manage the overall number of displays and avoid unproductive displays.

2. Draw a plan - o - gram of your selling area that depicts the location and number of packs on each display for all cigarette displays by company. Note location of your cash register in your store plan - o - gram.

Selling Area _____

Another principle: Visible inventory should be proportionate to sales.

3. Turn back to page #9 of this guide. Review the list of your top ten selling brands from question #1.
 - Are your display inventories in balance with sales? Why or why not?
 - What would you suggest?

Principle #4: Use promotions and advertising to build store traffic.

4. List promotional product you are now offering to your customers by cigarette brand family.
Ask yourself:

- Are these promotions significantly building store traffic?
- How many days, on average, will each promotion last on my counter or selling area before it sells out entirely?
- How do these promotions impact my sales and profits?
- What changes would you suggest?

Last Principle: If you have price sensitive shoppers, offer a private label or promote a Discount brand.

5. What percentage of your total store's cigarette sales dollars is represented by premium brands?
6. What percentage of your total store's beverage sales dollars is represented by premium brands?
7. What percentage of your total store's sales dollars is represented by value shoppers?
8. Ask yourself:
- Is price promoting using a private label or Discount brand appropriate with my customer base?
 - What changes would you suggest?

IV. Inventory Management

The best way to maximize tobacco department profitability is by managing your inventory effectively to avoid two big profit-killers: under stocking and overstocking. Under stocking loses sales, and overstocking wastes inventory dollars.

Good inventory management ensures that you have enough product to meet consumer demand, minimize overstocking costs, and build in enough flexibility to handle changes in customer demand and sales trends.

You have a number of tools to help you. The store inventory and ordering guide, available from your distributor, is one. Your tobacco manufacturers' inventory and ordering guides are another, and these include information to help you decipher product freshness codes. Computers and scanning equipment are another source for maintaining inventory .

Inventory management is crucial to protecting the profits you can get from cigarettes. To establish profitable inventory levels and to order efficiently, you need to:

- Track weekly sales for each brand packing by the carton and pack.
- Determine order frequency. That is, how many orders do you receive each week?
- Create an inventory base equal to 150% of weekly sales.

Here s an example:

Suppose your store sells an average of 20 cartons per week of Marlboro Medium, and your target base inventory equals 150% of weekly sales.

Step 1:

To calculate base inventory, multiply the number of sales by 150% (20 cartons x 150% = 30 cartons.) Review this figure periodically and adjust it according to changes in brand sales.

Step 1	
Average sales	20 CPW
	<u> x 150%</u>
Base Inventory	30 cartons

Step 2:

Count inventory on hand and determine what you need to order. In our example, 8 cartons of Marlboro Medium were on hand the first week; so enter 8 in the “on hand” column for the week of January 3. If you need a base inventory of 30 cartons, and you have only 8 remaining, obviously you need to order 22 more cartons, or 30 minus 8. In this example, the order for Marlboro Medium is 22 cartons.

Example															
Date				1/3			1/10								
		ROWS ALLOCATED	INVENTORY BASE	ON HAND	ORDER	SALES	ON HAND	ORDER	SALES	ON HAND	ORDER	SALES	ON HAND	ORDER	SALES
Brand															
Marlboro Lights	5370	3	30	8	22										

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To determine sales for January 3, subtract current stock on hand, 7, from the inventory base, 30, which equals 23.

Example

Date		1/3				1/10				
		PACKS ALLOCATED	INVENTORY BASE	ON HAND	SALES	ON HAND	ON HAND	SALES	ON HAND	SALES
Brand										
Marlboro Lights	6370	3	30	8	22	7				

As you get to know your local market, you may want to fine-tune base inventories beyond the 150% rule. Some industry experts recommend the following base inventory guidelines. For brand packings that rank—

- 1-10 in sales, set base inventories to 200% of weekly sales.
- 11-100, set base inventories to 150% of weekly sales.
- 100+, set base inventories to 130% of weekly sales.

Whether you fine-tune as we just described or use the 150% calculation for all packings, you need to monitor and adjust your inventories as demand dictates.

Turn Rate:

For the slower sellers, assume a minimum inventory of one carton, and evaluate packings that turn less than twelve times per year. This means packings whose sales average less than two packs a week. Generally any packing that *turns* less than twelve times a year.

What is the significance of *turns*? *Turn rate* tells you how many times your average inventory sells off the shelf for a specific time period. Generally, the higher the stock turn, the better, because—

- Your inventory dollars are more productive.

Example: Say you have a \$1.00 invested in inventory and every time a product turns, you make 50¢ on that investment. If the product turns 10 times, you make \$5.00; if it turns only 2 times, you make only \$1.00. The trick is to find the balance that will give you the most turns while at the same time avoiding under stocking or overstocking.

- Fresh merchandise is always on the racks.
- Lower storage costs result from maintaining the right amount of inventory and avoiding overstocking.

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Here s how you compute turn rate:

Let's say your store sells 150 cartons per week, all pack sales. Premium brands account for weekly sales of 112 cartons. The average pack inventory on premium brands is 1,300 packs. To compute turn rate for the premium brands:

- First, convert the average weekly carton volume for premium brands to packs by multiplying 112 cartons by 10. (There are 10 packs to a carton.) This equals 1,120 packs.
- Multiply 1,120 by 52 weeks to get your annual pack sales. Answer: 58,240.
- Now, to determine the number of turns on premium brands, divide your annual premium brand pack sales 58,240, by your average premium brand inventory, 1,300. The number of turns is 45.

Turn Rate	
Annual Sales _____	= Inventory Turn Rate
Average Inventory	
58,240 Annual Premium Pack Sales _____	= 45
1,300 Avg. Premium Pack Inventory	

In this example, a turn rate of 45 indicates a solid performer. As noted earlier, brands that turn less than 12 times per year should be reviewed closely for possible elimination.

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Product Maintenance and Care

Another aspect of managing your inventory to maximize and protect sales is product maintenance and care. You can quickly lose a sale by selling a stale pack of cigarettes, and you can lose a customer if it happens repeatedly.

Cigarettes have a shelf life of between 10 and 12 months—10 in hot, dry climates; 12 in cooler, moderately humid areas. (Incidentally, when cigarettes are stored near ovens or other heat-producers, their shelf life can be shortened dramatically.) You'll want to rotate your stock, moving the older packs and cartons out first, so they'll sell when they are most fresh.

How do you determine product freshness? For cartons it's easy—the product date is coded on the end flap. Packs are more difficult. Once a pack is out of the carton, you have to open it to see the coding, which most manufacturers have on the foil wrap *inside*. This of course destroys the package, but it helps you to judge the freshness of the remaining packs from the carton. Talk to your tobacco company representative about any questions you have on pack date coding.

Storage environment also affects quality, as it does with many other consumer products. Cigarettes may absorb odors and moisture, and should be stored in a cool, dry area, away from products with strong odors, such as air fresheners and soaps; removed from the food preparation areas, where a spill of grease or liquid could ruin them; and away from petroleum products, where leakage might be a problem.

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TEST YOURSELF: INVENTORY MANAGEMENT

1. The purpose of this exercise is to illustrate the potential cost of an out-of-stock.

The following information is given:

Your store volume is 500 cartons/week. The out-of-stock brands and their market shares are:

Marlboro Red Box	6.40
Newport Box Kg	3.66
Marlboro Medium Kg	3.25

You sell packs for \$2.25. Today is Tuesday morning and you are OOS on the above; cigarette delivery date is Friday night.

Your store's business is apportioned as follows:

<u>Day</u>	<u>% of business</u>
Monday	11%
Tuesday	10%
Wednesday	15%
Thursday	19%
Friday	17%
Saturday	19%
Sunday	9%

Use the information given to complete the following.

With your next order arriving on _____, you will be OOS for _____ days. During this period you will be unable to sell _____ packs of the above brands, which at \$_____ per pack, represents lost sales of \$_____.

- The purpose of this exercise is to help you set the stage for establishing an inventory base. It demonstrates how to average weekly cigarette sales and use these averages to identify sales trends.

CARTONS SOLD PER WEEK FOR ONE MONTH

Listed below are five nationally top-selling brands:

- Determine the *total* number of cartons sold for each over the four-week period.
- Then calculate the *average* number of cartons sold per week over the four-week period.
- Determine your inventory base for each brand packing.

	<u>Wk1</u>	<u>Wk2</u>	<u>Wk3</u>	<u>Wk4</u>	<u>Total</u>	<u>Avg.</u> <u>Ctn/Wk x 150%</u>	<u>Base</u>
Marlboro Box King	11	12	14	12	_____	_____	_____
Marlboro Lt. Box King	5	5	7	8	_____	_____	_____
Newport Soft King	2	3	3	4	_____	_____	_____
Winston Soft King	7	7	6	6	_____	_____	_____
Kool King	4	3	4	3	_____	_____	_____

V. Profitability and Pricing Strategy

When you compare tobacco to other product categories, you can see the importance of cigarettes to overall store profitability.

As a percentage of in-store gross profits, the cigarette category is clearly ahead of the next two categories—beer and soft drinks. Cigarettes accounts for 19.38% of store gross profits. Beer is 9.73%, and soft drinks are 9.63%.

The average convenience store sells 1750 packs of cigarettes a week. At an average selling price of \$2.00 per pack, they generate sales of \$3,500. With gross margins averaging 23%, that yields a gross margin dollar figure of \$805 per week, or \$41,860 per year!

Profit margins and the penny profits generated from cigarette sales are influenced by your pricing strategy and what you emphasize in your product selling mix:

- Do you want to have the lowest priced product in order to drive volume?
- Do you want to make more profits per sale by establishing higher margins?
- Do you want to focus more on premium brands or do you want to focus more on discount brands?

These are the most important decisions you will make in managing this category.

Establishing your price strategies can be influenced by other factors, too:

- You or your company may have certain profit margin guidelines that dictate what your prices will be based on cost of goods.
- If you operate in a fair trade state, State Law may regulate the minimum price you can charge for packs and cartons.
- Local competition may influence your cigarette price in order for you to be competitive. If cigarettes are used as a traffic draw, you'll want a pricing policy that is attractively low.

Earlier, we discussed pricing in product selection and the price differences among price tiers. These price differences influence how much profit you can realize from the category. The latest Philip Morris Convenience Store pricing survey reports that the average gross margins on each price tier are:

Premium brands	23%
Discount	15%
Deep discount	6%

Of course, these margins are only averages and can vary from location to location. It's a complex situation: Premium brands yield the highest profit margins, but shoppers are increasingly looking to stretch their dollars by buying discount and deep discount brands.

Despite this trend, you gain a number of benefits by emphasizing premium brands:

- You see greater penny profits from the sale of premium brands. When consumers trade down to lower price tiers, you earn lower profits.
- Industry Nielsen market share reports show that premium brands generally sell better and turn more often than discount brands. This higher volume, combined with greater penny profits, means premium brands often contribute more to category profitability than other price tiers.

Two important calculations help you compare the profitability of each price tier: Gross Margin Dollars or Gross Profit and Gross Margin Percent. Here's an example.

Your store sells brands in the three cigarette price tiers: premium, discount, and deep discount. The first step in determining gross margin percent is to calculate the gross margin *dollars*, or profit per pack.

Price Tiers	Carton Cost	Pack Cost	Pack Retail
Premium	\$17.00	\$1.70	\$2.20
Discount	\$13.00	\$1.30	\$1.55
Deep discount	\$10.00	\$1.00	\$1.07

1. Starting with premium brands, to determine gross margin dollars, or profit, per pack, subtract the cost of \$1.70 from the selling price of \$2.20. The profit: 50¢ per pack.

Profit Calculation	
Selling price	\$2.20
Cost	<u>-1.70</u>
Gross profit	.50
or	
Gross margin dollars	

Once you complete the profit per pack calculation for each price tier, you can begin a more in-depth profit analysis of each price tier by looking at gross margin percent.

2. To calculate gross margin percent, divide your 50¢ profit per pack by the retail selling price of \$2.20. The result is 22.7%.

Gross Margin % Calculation

$$\frac{\text{Profit per pack } (\$.50)}{\text{Retail selling price } (\$2.20)} = 22.7\% \text{ GM}$$

- For every dollar of premium brands sold, 22.7¢ is gross profit, or GM\$.

Gross margin percent enables you to compare how much you make dollar-for-dollar on each product sold in your store. In this case, the gross margin of 22.7% means that for every dollar of premium brands sold, 22.7¢ is gross profit, or gross margin dollars.

Pricing strategy is a complicated issue, and your tobacco sales rep is specially trained to help you decide how to maximize the profitability of your cigarette department. In fact, your Philip Morris sales rep can provide you with helpful tools, including a computer model that can guide you in establishing your pricing strategies.

TEST YOURSELF: PROFITABILITY AND PRICING STRATEGY

Note: The following questions apply the information found in the following case scenario.

Case Scenario -- Your supervisor needs the retail dollar value of your store's cigarette inventory. Today you have 2000 packs of Premium brands, 1000 packs of Discount product and 1200 Deep Discount packs. Premium packs cost \$1.50 each and retail for \$1.95 per pack. Discount packs cost \$1.30 each and retail for \$1.60 and Deep Discount packs cost \$1.20 each with a retail price of \$1.35 each.

1. Calculate the cost of cigarette inventory by price tier and for the entire category.
2. For the above scenario calculate the Gross Margin percentage and Gross Profit for each of the three cigarette pricing segments.
3. Using the information from the scenario, calculate the total weekly Gross Profit from the cigarette category if 1200 packs of Premium brands were sold and 500 packs each of Discount and Deep Discount brands were sold.
4. Three months ago your retail prices by segment were: Premium brands at \$1.85 per pack, Discount brands priced at \$1.70 and Deep Discounts at \$1.40 per pack. Your cigarette category's pack costs were the same then as today. Your store's weekly pack sales mix by segment three months ago averaged: 1700 Premium pack sales, 400 Discount packs and 200 Deep Discount pack sales.

Review the profitability data then and now from the three previous questions and recommend any pricing changes to the cigarette category as your strategy to improve store profitability. Be prepared to support any pricing changes with financial data

VI. Promotion and Advertising

The results of extensive research have provided some significant facts about cigarette promotions. They:

- Build store traffic
- Increase impulse sales.
- Encourage repeat purchases and customer loyalty.
- Show price or value advantage against store competition.

The keys to successful promotions are:

- Use only those promotions that are likely to generate incremental sales and that feature well recognized brands.
- Widely advertise promotions to attract new customers to the store.
- Place promotions that appeal to the demographics of your market.
- Be alert to new ways to promote the product. Manufacturers are continually offering new approaches such as 2-pack and 3-pack promotions.

Promotions that build traffic not only contribute to sales of the promoted item; the additional customers are likely to purchase other, unpromoted items, too.

Here are some of the different types of promotions offered by cigarette manufacturers:

- Cents-off or dollars-off coupons or stickers featured on packs or cartons.
- Mail-in offers, in which coupons or product are sent to the consumer.
- Incentive items, attached to either packs or cartons.

- Bounce-back offers, which are similar to mail-in offers and originate within the packaging of an incentive or product. These are like a “promotion within a promotion.” An example would be a free lighter attached to two packs, and along with the lighter a mail-in offer to receive a buy-one-get-one-free coupon on your next pack purchase.
- Buy-downs, in which the manufacturer buys down the price of the product to the retail outlet and this price reduction is passed on to the consumer. Usually, the manufacturer’s rep reimburses the store for this reduction.

While these represent most kinds of promotions that are available, there are others which sometimes involve customization. Be sure to consult your local sales representative for available promotions.

Before we continue let me discuss a progressive plan to help you build store traffic, sales and profits -- *Initiate store sponsored cigarette promotional programs*. A good number of C-stores nationally are already successfully running their own programs to attract new shoppers and improve their inside sales volume. (At times cigarette manufacturers may even help you get started by co-sponsoring a portion of your own price incentive program with accrued funds from their merchandising plans.)

Two such store sponsored promotional programs are:

- "Multi" pack purchase programs -- offering consumers a per pack savings for purchasing 3, 4 or 5 of their favorite brand.
- Price Promote Your Best Brands -- use brands like Marlboro, with high market recognition or even the entire Premium cigarette segment to work and improve your store's customer traffic, sales volume, incremental inside sales. Build on the fact that Premium cigarette shoppers spend more per trip and studies indicate a higher rate of brand loyalty for Premium than Discount smokers. A link may even exist between brand loyalty and where they shop. What do you think?

Break-even Analysis is an important tool that shows the relationship of volume objectives and gross profits. If you consider changing retail prices or offering volume discounts (3,4 or 5 pack specials), what volume level will you need to reach at the new price to earn the same amount of gross profit?

There are two quick ways to figure the break-even point, the Gross Profit and Gross Margin methods. Here is how you compute each:

Gross Profit per Pack Method

By knowing how many packs were sold and how much Gross Profit (selling price minus cost) or Gross Margin Dollars (GM \$) you earned prior to the promotion you can quickly calculate and compare the "break-even" point with the promotion.

- Calculation (compare findings):

Total GM \$ earned ÷ GM\$ earned per pack

Example -- Reducing Premium Segment Price by 10 cents:

Without Promotion:

$\$500 \div \$0.50 = 1000$ packs

With Promotion:

$\$500 \div \$0.40 = 1250$ packs

In the above example 250 additional packs or a 25% sales increase at the new promoted price is the "break-even point" to earned the same gross profit. Additional sales above this new sales level means additional gross margin dollars for your store.

Gross Margin Percentage per Pack Method

By knowing total dollar sales and the Gross Margin % (Selling price minus cost ÷ Selling price) you earn prior to the promotion, you can quickly calculate the "break-even" sales volume you'll need for the promotion.

Here's the two step process:

Step 1. (Prior to Promotion)

Sales x GM % = Gross Profit or Gross Margin \$

Step 2.

GM \$ (from step 1) ÷ New GM % = New Sales \$

Example -- Reducing Premium Segment Gross Margin % from 33% to 28%:

Without Promotion:

Step 1.

\$1,500 x 33% = \$500 Gross Profit or GM \$

With Promotion:

Step 2.

\$500 ÷ 28% = \$1786 (rounded to full \$ figure)

In the above example \$286 additional dollar sales or a 19% sales increase with the new promoted Gross Margin percentage is the "break-even point" to earned the same gross profit. Additional sales above this new sales level means additional gross profit for your store.

Just as promotions can increase business, so can point of sale advertising, especially when it's in the right place. Different types of point of sale advertising have different functions. POS advertising can:

- Attract customers to your store.
- Draw attention to pricing information or other store messages.
- Showcase your customized store logo for easy customer identification.
- Provide utility or functional value for either you or your customers; for example, ash trays, shopping baskets, change mats, and so on.

Remember, cigarette manufacturers, like Philip Morris, can provide you with signage for your store.

TEST YOURSELF: PROMOTION AND ADVERTISING

1. Name four benefits of cigarette promotions to your store.

1. _____
2. _____
3. _____
4. _____

2. Name four types of promotions that are offered by cigarette manufacturers.

1. _____
2. _____
3. _____
4. _____

3. Name two types of store sponsored cigarette promotions?

4. What is the break-even point for each of the following accounts?

- Account X contemplates lowering the retail price on Premium brands and earning a 25% gross margin percentage for each pack sold. Currently the Premium single pack gross margin percentage is 30% and sales average 1,000 Premium packs per week.
- Account Y currently sells 500 Premium packs each week and earns 25 cents per pack. The owner plans to lower the gross profit per pack on Premium brands to 20 cents.

VII. What Your Tobacco Rep Can Do For You

Your tobacco sales rep can—

- Educate and train your store personnel in how to manage the category. How well your people do this can strongly impact the profit you make from cigarettes.
- Keep you up-to-date on low and out-of-stock conditions at each store visit.
- Track product movement and inventory depth.
- Demonstrate and conduct proper stock rotation on carton and pack fixtures to ensure inventory freshness.
- Teach the product date coding systems of the different tobacco companies. Date coding knowledge is key to knowing what's moving and what's not.
- Identify the best storage locations and conditions for cigarettes.
- Advise on locations and methods for maximum product movement.

In many ways the tobacco sales rep can be another hand to help you in your store. This professional can work with you to set up an inventory management program and provide the inventory ordering guide that will help you monitor inventory and simplify your order preparation. More than that, your rep may track the inventory for his or her company's brand packings and help you place orders for those products.

Share of market data for your local market area is something else your rep can give you from highly reputable report sources such as Nielsen, Maxwell, or MSA. This information can be critical for keeping you in line with your customers' preferences.

Information about local economic conditions and trends, which can also affect your product mix and pricing, can be supplied to you by the tobacco sales representative, along with data on industry trends which alert you to new developments that may influence consumer requests. New or pending government guidelines or restrictions on tobacco, including tax proposals and legislation on Federal or local levels, can be provided by your rep. And of course, your rep will tell you about brand introductions at local or national levels.

Your tobacco sales rep will help set up your temporary displays as well as your permanent programs. In addition to servicing the displays, your rep can teach your employees how to keep your displays attractive and well stocked with the appropriate brands that will generate profits from your valuable counter space. Temporary and permanent point of sale items such as counter balance signs, coffee service centers, store hour signs, and shopping baskets that will attract and provide convenience for your customers are available through your rep.

The services that your cigarette sales representative provides can be of significant help in increasing your profits from this category.

Use your cigarette sales representative's expertise, along with the information in this Reference Guide, to fully realize the potential profits from the cigarette category.

TEST YOURSELF: WHAT YOUR TOBACCO REP CAN DO FOR YOU

This exercise reviews guidelines for keeping your cigarettes fresh plus displaying and merchandising your packs.

Answer the following questions.

1. Since cigarettes do not need refrigeration, they have an indefinite shelf life.
True or False?
2. Of the following items, which one would be the safest to store cigarettes next to?
 - a. salad oil
 - b. automobile air fresheners
 - c. paper towels
 - d. laundry detergent
3. Your store has just had a new cigarette package fixture installed for your cigarette packs. Give at least two methods that could be used to set up and organize your packs.
 1. _____
 2. _____

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VIII. *IT's THE LAW*

This topic is extremely important to all retailers that freely choose to sell tobacco products. This subject is especially important to the C-store Industry because our stores are frequently shopped by those younger than age twenty - one and we welcome their patronage.

Sports Illustrated for Kids, a magazine geared towards teenagers and pre-teens or "tweens" (eight to twelve year olds), conducted a study in 1993 in which 1,200 of its readers responded. Their research indicates that 44% of those interviewed shop at C-stores once per week, with 91% saying they go to a C-store at least once per month.

Our C-stores offer children a perfect opportunity to shop for the items (candy, snacks, soft drinks, magazines, playing cards, etc.) they like to purchase with their weekly allowance or earned income from part-time jobs.

Teenagers and "Tweens" look at C-stores as a place to make their own purchasing decisions for the products they want. This age group shopper experiences independence and freedom from parental consent with their purchasing power. In other words, teenagers and "tweens" shop our stores, make purchasing decisions and enjoy acting like adults. However, teenagers and pre-teens are not adults.

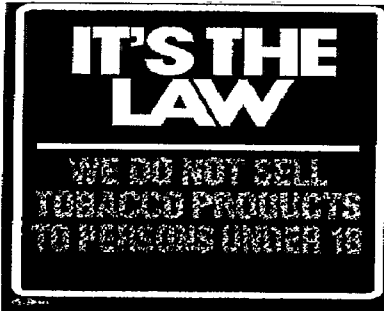
Smoking is an adult activity. That's why laws have been passed to keep tobacco products out of the hands of those underage. As owners, managers or employees of C-stores , our responsibility is clear:

Don't sell tobacco products to anyone underage.

It's our responsibility and IT's THE LAW.

We don't want minors to smoke, so Philip Morris helped develop the **It's the Law** program. It's our way of helping you prevent cigarette sales to minors, and it's free.

Example of Ad from a Market With 18 as the Legal Age to Smoke




Tens of thousands of retailers are participating in a voluntary national program called "It's the Law" because they do not want anyone under 18 years of age to buy cigarettes. They want to demonstrate their support of existing laws prohibiting cigarette sales to minors.

Philip Morris salutes the many retailers who support "it's the Law."

Our goal is to work together to ensure that this sign appears wherever cigarettes are sold.

If you would like to join the thousands of retailers participating in this program, please write to us or call 1-800-343-0975 and please give us your name and address. We'll send you a free "It's the Law" kit.



PHILIP MORRIS
U.S.A.
120 Park Avenue
New York, NY 10017


Keeping cigarettes away from young people is not only in their best interest -- it's also in our best interest.

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All 50 states and the District of Columbia have minimum age sales laws (18 everywhere but Alabama, Alaska and Utah where the age is 19). Some states have additional requirements including special signage

Further, recent federal law requires states to have a program to enforce underage sales laws for tobacco. To comply with the new law, police are being asked in some states to use undercover minors in sting operations against retailers. Some states are raising the penalties for underage sales. Some states are requiring retailers to hold -- and pay for -- tobacco sales licenses.

Example of Ad from Chicago Market



Undercover minors will attempt to purchase cigarette, cigars, or other tobacco products. Anyone who sells cigarettes or other tobacco products to a person under age 18 is subject to a fine of up to \$500 for the first violation and up to \$1000 for subsequent violations.

In addition, violators may lose their licenses to sell tobacco products and face up to 30 days in jail.

This is serious business! Make it your business -- know your rights, and know the Law:

- Customers must be 18 or older to buy cigarettes or any other tobacco products in this store;
- Customers must be able to prove their age with valid ID, just as they must when buying beer or wine;
- You do not have to sell cigarettes to anyone, even a customer who shows you ID;
- If you are not absolutely convinced the ID is authentic and valid, do not sell the customer cigarettes or any other tobacco product.

Some of the **It's the Law** program elements that can assist you in ensuring that your employees know and comply with the law include:

- A state specific brochure outlining your state's code;
- Different sized decals to display on door, window and cash register and;

¥ A tip card on what to look for when checking identification;

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We can prevent minors from smoking, and protect our businesses, by following these five steps of the **It's the Law** Program:

First-- Know your state law;

*Second-- Use free **It's the Law** materials to educate your employees about their responsibilities;*

*Third-- Post **It's the Law** signage in prominent locations, including on your front door and cash register;*

Fourth-- Instruct employees to ask for ID from anyone trying to buy cigarettes who looks 25 or younger;

And last-- Enforce the law. Do not sell cigarettes to minors.

Working together, we can address the problem of cigarette sales to those below the legal age -- and preempt additional government regulation of retailers. For information about **It's the Law**, or for free education materials or signage, call toll-free (800)343-0975.

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TEST YOURSELF: IT'S THE LAW

1. What is the minimum age in your state to sell anyone cigarettes?
2. List the five steps of the **IT's THE LAW** Program:

3. What is the toll- free telephone number to dial for information about the **IT's THE LAW** program or for free educational materials and signage to help you address the problem of underage smoking?

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