

CLEARING THE AIR
Philip Morris International's Smoke-Free Future

MANAGEMENT DECISIONS

The authors prepared this case solely as a basis for class discussion and not as an endorsement, a source of primary data, or an illustration of effective or ineffective management. Although based on real events and despite occasional references to actual companies, this case is fictitious and any resemblance to actual persons or entities is coincidental.

The Management Decision

A Fully Dedicated Store

The main challenge for Philip Morris International (PMI) was developing a positioning strategy to which stakeholders do not associate IQOS with the traditional brands of cigarettes belonging to PMI's portfolio. In other words, the company wanted the product to be perceived as something totally different from the common tobacco products, which could not only accommodate the widespread desire for healthy lifestyles but that could also revitalise the image of the smoker.

For these reasons, the most revolutionary element of PMI's strategy was at a distribution level. The company, in fact, decided to set up dedicated stores, where customers could go to try and eventually buy the electronic device. Two rationales were behind this choice. First of all, the fact that a smoker has to go to a specific store rather than to a classic tobacco shop is a very effective way to communicate the message that IQOS is not a substitute or an equivalent of a cigarette. It emphasises the fact that the device belongs to a radically different product category. Secondly, being IQOS such a new product, PMI recognised the need of educating the customers to its use. Therefore, a stand-alone store allows the sales force to have a very direct relationship with the customer, thereby making it possible to provide him/her with precise information about the characteristics of the device.

The location and the layout of the IQOS stores were strategically appointed with the aim of modifying the image of the smoker. All the IQOS stores are purposefully located in the richest parts of the city centres. For example, the IQOS store in Bologna (Italy) is in Galleria Cavour, a shopping area of the city centre where the most luxurious stores are, such as Louis Vuitton, Michael Kors, Prada, Tiffany & Co; the IQOS store in Milan is in Corso Buenos Aires, next to other boutiques like Vans and Lacoste; and the IQOS store in Sofia (Bulgaria) is inside the biggest shopping mall of the city, Paradise Centre, where high-end brands like Moschino, Pandora and Swarovski can be found. It is clear that PMI's goal is to create associations between its products and these luxury stores, to generate a prestigious image of IQOS. This perception is reinforced by observing the layout of the store: the inside is generally very bright and elegant, with plants and mirrors to build an exotic atmosphere. The employees normally wear suits, so as to provide the patron with an idea of fineness, which is often strengthened by the nu lounge music in the background. **Exhibit 1** and **Exhibit 2** are examples of IQOS stores: the former is from Bologna and the latter is from Sofia. The location and the layout of the stores, therefore, enable PMI to radically change the image of the smoker who is not perceived as the unsophisticated Marlboro man, but as a polished and elegant businessman.

Exhibit 1: Interior of IQOS Store in Bologna



Exhibit 2: IQOS Store in Sofia



The Partnership Strategy

For Philip Morris International, the development of the IQOS was sure to strain their existing partners who have partnered with them to sell their traditional tobacco products. The creation of a bespoke story with a distinct and unique set of values for IQOS was sure to send more shockwaves through the supply chain, and the partners who work with PMI in receiving and selling the more traditional tobacco and cigarette brands and products. Not only was this seen as a change in philosophy from PMI, but also a change in the supply chain.

However, PMI was very much aware of the impact which this may have in terms of their front-facing partners. Despite the move to the IQOS store, the organisation was very conscious to keep their partners as part of the supply chain and the selling process of the brand. With this mind, the launch of IQOS presented a new opportunity, in fact, for PMI to provide a new product for their partners. Although the IQOS device would only be sold exclusively at the IQOS store location; the actual Heets, the tobacco sticks which were to be sold and used only in the IQOS devices, would be sold at their partner stores, similar to other tobacco products. The organisation even moved to allocating all outlets which sold Heets and other IQOS products and accessories as "IQOS Dealers", and their store can be found, based on their location, on the IQOS website (Exhibit 3).

Exhibit 3: Swedish IQOS Dealers on IQOS Website

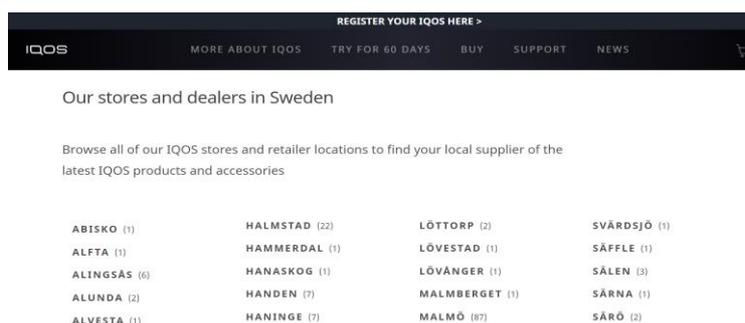
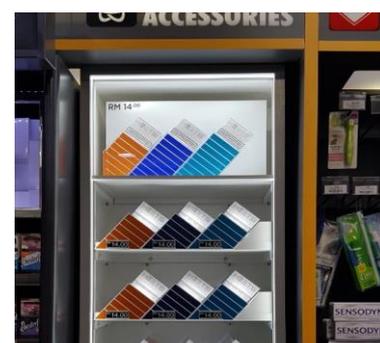


Exhibit 4: IQOS In Retail Store



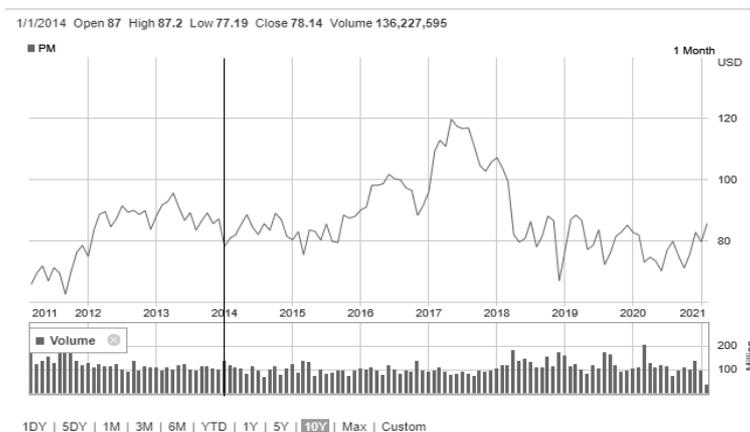
Furthermore, PMI wanted to keep its own brand away from IQOS, launching IQOS using their traditional house of brands approach. The organisation, although developing a new product to fit a changing philosophy, kept the same internal processes for brand launch and distribution of the Heets. The organisation has also welcomed the branding of IQOS strictly to adult audiences, and to appease and work with regulators to be able to bring the IQOS to new markets in a safe way, and to target the right audience. This is exemplified by the application of Philip Morris International to sell IQOS in the United States and promising to work closely with the Food & Drug Administration in order to bring and promote the IQOS to the States, and to the right target audience - adult smokers¹.

Impact on the PMI Brand

The introduction of IQOS was a turning point in the efforts of Philip Morris International to change their perception among consumers, and to signal the other tobacco giants that they need to augment their product offerings in order to remain competitive. PMI is a company that is known to invest the most on R&D compared to the other big tobacco giants, and their decision to introduce IQOS was a complete shock to the industry. It was a bold and unexpected move from the company that primarily relied thus far only on its famous brands - Chesterfield, Parliament and Marlboro.

When the company moved its HQs to Switzerland, it invested heavily on its new R&D facility, employing over 400 scientists. The development of IQOS was a breakthrough innovation in the industry and the company invested more than 3 billion US dollars, which was at the time an all-in investment. The official launch of the smoke-free device was announced in 2014. It caused a lot of attention and steer into the press and in the stock markets - in **Exhibit 5** below you can observe that when PMI announced the launch of its heated smoke-free device, the stocks of the company fell in 2014 to 79 US dollars:

Exhibit 5²: Share Price of PMI (2011 - 2021)



¹ <https://www.cnn.com/2019/04/30/fda-clears-igqos-philip-morris-heated-tobacco-device.html#:~:text=The%20U.S.%20Food%20and%20Drug,generate%20a%20nicotine%2Dcontaining%20aerosol.>

² <https://www.pmi.com/investor-relations/pm-stock-and-bond-information>

This was not the anticipated impact that PMI executives theorised in their meetings, so they decided to bolster the new product and image by creating educational campaigns, presenting the benefits that the product brings to the smokers by creating focus groups, and showing scientific reports. Furthermore, as mentioned in the previous section, they decided not to portray IQOS as a product by Philip Morris, because after the unanticipated results, the company decided not to take further risks. The association of PMI with conventional cigarettes and smoking is still very strong among smokers and this presents a further challenge to the company. However, this is a slow process and persistence is important for the company. In 2016 they officially changed their business vision to promote a smoke-free future, which officially meant the departure from regular smoking, changing completely the PMI brand. They made the bold mission to shift 40 million smokers to use smoke-free products such as IQOS, and in **Exhibit 6** you can observe the impact of IQOS on the rest of the company's portfolio - each year the shipment value of cigarettes is declining. In addition, in **Exhibit 7** you can observe the success of the recent company efforts - the company already managed to attract 13.6 million people to use IQOS:

Exhibit 6: Shipment Volume of PMI Traditional Cigarettes Per Annum

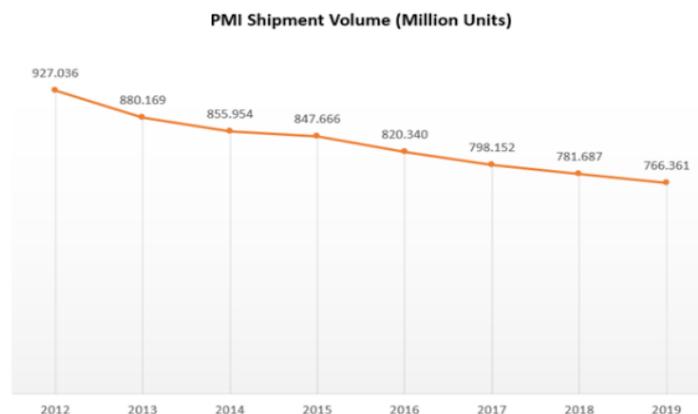


Exhibit 7³: Number of IQOS Users Per Quarter (2018 - 2019)



³ <https://seekingalpha.com/article/4335897-philip-morris-this-is-why-iqos-will-push-stock-higher>