Cigarette pricing 1 year after new restrictions on tobacco industry retailer programmes in Quebec, Canada

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ABSTRACT

Objectives Over the past 15 years, tobacco companies operating in Canada abandoned their long-standing unitary price model in favour of price differentiation. Concerns about low cigarette prices were identified by the Quebec government in 2015 when it introduced restrictions on the types of incentives that tobacco manufacturers may offer to retailers. This study sought to explore cigarette prices in Quebec 1 year after these restrictions came into effect.

Methods Details on cigarette trading terms and programmes were obtained from websites maintained by retailer groups. Visits were made to tobacco retailers in four Quebec municipalities in the autumn of 2017. The price displayed for cigarettes was observed and recorded in 273 convenience stores.

Results Two forms of price differentiation were observed. The first was price-segmentation between brands, reflected in a difference of $3 or more in the average displayed price between premium and discount brands of each manufacturer (ie, $10.48 vs $7.43 for a package of 20 cigarettes of the most and least expensive brands sold by Philip Morris International). Price localisation was also observed, reflected in a $2 range of prices between retail outlets for the same package of cigarettes. Even among outlets of a given chain of convenience stores, the price of the least expensive brands varied by more than $1 per package. The size of the variance in prices rivals or exceeds the size of tobacco tax increases in Quebec over the past decade.

Conclusions Recent restrictions on tobacco industry incentive programmes for retailers have not ended price differentiation. Tobacco manufacturers' and retailers' pricing policies continue to provide price-sensitive smokers with ways to avoid the impact of tobacco tax increases.

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INTRODUCTION

The WHO reports that 'increasing the price of tobacco through higher taxes is the single most effective way to encourage tobacco users to quit and prevent children from starting to smoke.'[1] Taxes, however, are but one component of the purchase price of tobacco products. Contributing to the non-tax portion are supplier's costs, supplier's pricing strategies and market conditions. This paper identifies the capacity for tobacco companies to influence the non-tax retail price of cigarettes in Quebec, even following the adoption of regulatory reforms intended to curb these practices.

Tobacco industry pricing strategies in Quebec

Under the tobacco control laws in force in Quebec, tobacco companies are prohibited from offering consumers price-related incentives, such as coupons, contests and giveaways. These same laws, however, expressly permit informational advertising for price, including price signs at retail, and impose no restrictions on how that price is set.[2–4] Tobacco companies may charge less for higher volume sales (such as bundled packages or cartons), for some brands than for others, to some retailers than to others, in some locations than in others and at some times than during others. There are no restrictions on selling below the cost of production, or cross-subsidising losses on some brands with higher profits on others.

These laws were adopted in the late 1990s when each of the three multinational tobacco companies operating in Canada sold all their cigarette brands at the same wholesale price. Canada was unusual in this respect, as the same companies price-segmented their market in most other countries.[5] It was only in the early 2000s that the Canadian operations of these companies introduced discount brands[6] which by 2015 had claimed two-thirds of the market.[7]

Ninety-five per cent of the Canadian market for manufactured cigarettes is supplied by three firms: British American Tobacco (BAT), Philip Morris International (PMI) and Japan Tobacco (JTI).[8]

In addition to expanding the presence of *lower cost brands* over the past decade, the companies have also developed ways to establish *lower-cost retail outlets*. One way they do this is to charge different wholesale prices to different retail outlets, a practice that only became legal in Canada in 2009.[9] In advance of this change, BAT's subsidiary established direct control over distribution of its products to retailers in 2006, and PMI adopted a similar structure in 2014.[10 11]

All retailers who wish to sell their brands must first establish contracts with these companies. These contracts are nested within other trade or loyalty programmes which reward retailers for increasing their sales, for participating in manufacturers' training programmes or for engaging in 'other opportunities as designated by [the company]'.[12–14] Each of the three multinationals has its own branded retailer sales programme: BAT operates GO SMART,[15] PMI operates Connect/Connexions[16] and JTI runs Advantage-Plus.[17]

Details of these programmes (including the number of participating stores) are not made public, and participating retailers undertake to keep the details confidential.[18] Despite this, information

on the programmes can be found on the foreign-language websites of business associations serving recent Canadian immigrants.[19 20] These online discussions and translations of manufacturers' contracts provide insight into the direct and indirect pressure put on retailers to increase the number of cigarettes they sell, including by reducing prices. Such pressure is found in:

- The obligation of retailers to pay for cigarette shipments in advance, to accept a minimum non-returnable weekly amount, to accept overshipments that are reimbursable only after a period of several months.[21] Tobacco taxes are paid in advance by the retailer which increases the costs of maintaining excess inventory.
- The requirement that retailers who wish to be eligible for preferential wholesale prices meet sales targets that are set by the manufacturers.[22]
- The practice of offering deeper price discounts to retailers who take a smaller mark-up.[23]
- The awarding of loyalty points redeemable for merchandise, travel or other rewards in return for cigarette purchases or competitive position.[13]

In 2015, some independent retailers complained to the media about being pressured by these programmes to reduce their prices and profit margins.[12] This encouraged Quebec legislators to amend the provincial *Tobacco Control Act* to ban the offering to retailers of 'rebates, gratuities or any other form of benefit related to the sale or the retail price of a tobacco product'. This provision came into force in November 2016.[3]

Cigarette prices advertised in convenience stores in four Quebec municipalities

Approximately 1 year after the new provision of Quebec's tobacco law took effect, visits were made to convenience stores in a few Quebec neighbourhoods to look for indications of retailers being incentivised to lower their prices. The convenience channel was chosen because it accounts for 87% of tobacco product sales in Canada.[8]

METHODS

Central districts covering a total of 55.5 km^2 were identified in four Quebec municipalities, including the larger cities of Montreal, Quebec City and Gatineau and the smaller community of Drummondville. A list of 402 convenience stores in these areas was assembled from a trade association inventory,[24] Google Maps and the Yellow Pages. These locations were visited between mid-September and mid-November 2017, during which time the presence of cigarette sales was identified in 273 convenience stores of which 216 displayed price signs.

Table 1 Prices observed per package of 20 cigarettes in Quebec (inclusive of $5.14 in taxes)

	Number of stores in which price displayed	Percentage of stores with signs in which price displayed	Lowest price displayed	Median price displayed	Highest price displayed	Range in prices shown
British American Tobacco	192	89%				
Pall Mall	165	76%	$6.60	$7.38	$8.50	$1.90
John Player	120	56%	$6.52	$7.43	$9.15	$2.63
Du Maurier Superslims	60	28%	$7.19	$8.81	$10.90	$3.71
Peter Jackson	71	33%	$6.76	$8.11	$9.29	$2.53
Viceroy	45	21%	$6.67	$7.44	$8.10	$1.43
Du Maurier	36	17%	$8.48	$10.24	$11.50	$3.02
Pall Mall Superslims	17	8%	$6.52	$7.29	$7.62	$1.10
Player's	6	3%	$10.24	$10.98	$11.50	$1.26
Philip Morris International	175	81%				
Philip Morris	166	77%	$6.48	$7.43	$8.95	$2.47
Quebec Classique Noir	107	50%	$6.48	$7.49	$10.24	$3.76
Next Noir	106	49%	$6.52	$7.43	$9.51	$2.99
Next Superslims*	74	34%	$6.80	$7.42	$8.11	$1.31
Mark Ten	16	7%	$7.82	$8.16	$8.46	$0.64
Next—other variants	13	6%	$6.99	$7.63	$8.01	$1.02
Benson & Hedges *	3	1%	$9.99	$10.28	$10.80	$0.81
Benson & Hedges Superslims	1			$10.48		
Japan Tobacco	154	71%				
LD	146	68%	$6.52	$7.40	$8.33	$1.81
Macdonald Special Superslims	72	33%	$6.86	$8.1	$9.19	$2.33
Macdonald Special	55	25%	$7.30	$7.87	$9.29	$1.99
Camel	17	8%	$10.33	$11.29	$11.96	$1.63
Export A	3	1%	$6.82	$9.80	$9.92	$3.10
LD Club or Superslims	8	4%	$7.01	$7.52	$8.72	$1.71
Studio	8	4%	$7.29	$7.49	$8.20	$0.91

*Next Superslims and Benson & Hedges were only found in packages of 25 cigarettes but the prices have been restated as packages of 20 to allow for comparison with other brands.

A picture was taken of all price signs observed, and the prices were later transcribed. To facilitate comparison, the *package price* was standardised to that of a pack of 20 cigarettes, and the *product price* was established by subtracting the value of tobacco taxes ($5.14 per package of 20 cigarettes) from the advertised price.[25 26]

RESULTS

On average, each store with signs displayed the price of six brands. With the exception of one sign which referred to 'cigarettes économiques', all of the price signs observed identified the brand names of cigarettes made by the three major companies. The advertised purchase price for a package of 20 cigarettes ranged from $6.48 ($1.34 exclusive of taxes) to $11.96 ($6.82 exclusive of taxes). The results are shown in table 1.

Two forms of price differentiation were observed:

- *Price segmentation* (different prices for different brands in the same store): For each manufacturer, the average price displayed for premium brands (like Player's, Benson & Hedges, Camel) was more than $3.50 higher than the average displayed for economy brands (like Pall Mall, Philip Morris or LD). Because not all brands are identified on price signs, the true range of prices resulting from price segmentation is not known.
- *Price localisation* (different prices in different stores for the same product): For those economy brands most frequently identified on price signs, the posted price differed by $1.80 to $2.47 per package depending on the retail outlet.

The magnitude of differences in price charged by retailers and manufacturers is more apparent when analysing only the product price (exclusive of tobacco taxes). Price segmentation resulted in the average product price of BAT's premium brand Player's being 260% higher than its Pall Mall discount brand ($5.84 vs $2.24 per package). Price localisation resulted in the product price of Pall Mall ranging by almost as much, with a 230% difference between the non-tax price in the least and most expensive retail outlet ($1.46 vs $3.36).

Prices were localised even within branches of the same retail chain. For example, the revenue received by manufacturer and retailer for a package of Pall Mall among 28 outlets of Quebec's largest convenience chain, Couche-Tard, varied by 150% (from $1.95 to $2.93 without tax). Similar price differences were seen for other discount brands.

DISCUSSION

The price of cigarettes that was displayed in Quebec convenience stores in late 2017 varied considerably among brands and retailers. Because the study design was limited to one retail channel, one province and one source of price information, the results cannot be generalised across Canada.

Nonetheless, the results suggest that it may be possible for tobacco suppliers to use pricing strategies to reduce the impact of higher cigarette taxes. Tobacco taxes on cigarettes sold in Quebec increased by $1.60 per package between 2008 and 2018.[27–31]The price-sensitive smoker can largely sidestep a decade of nominal increases to tobacco taxes by switching from a premium brand to a cheaper brand, or by price shopping between retailers.

Tobacco companies have been obliged to report their wholesale prices to Health Canada since 2001,[32] and the average prices for each year since 2001 were made available in aggregate form in 2017. The average wholesale price per cigarette (exclusive of taxes and stated in 2004 dollars) was $0.081 in 2004, $0.085 in 2007 and $0.105 in 2016.[33] From this, it can be reasonably inferred that shortly after introducing price segmentation the companies were able to subsidise the lower prices charged for some brands or to some retailers with higher prices imposed on others. Had such cross-subsidisation not taken place, the average price would have been lower after discount brands were launched.

There is currently no system in place in Canada for health authorities to monitor, let alone control, the retail price of tobacco products or the extent to which manufacturers and retailers vary prices across brands and locations.

No country is known to have introduced regulations requiring the standardised cigarette pricing that was maintained by tobacco companies in Canada until the early 2000s. However, some countries, including France and Brazil, require all retailers to charge the same price for a given brand of cigarettes.[34 35] Other non-tax price policies, including minimum prices or limits on price variation, are gaining research attention as complements to tobacco excise taxes.[36 37] Such measures are already in place in Canada for other goods: Quebec imposes retail price controls on milk,[38] and Ontario sets a standard price for beer and cider in all stores.[39]

CONCLUSION

Multinational tobacco companies have recently created two forms of price differentiation in the Canadian cigarette market. The first is price-segmentation of brands, by which some versions of functionally equivalent products are sold at higher prices than others. The second is price localisation, which may reflect the manufacturers' ability to charge different prices to retailers and to otherwise influence retail pricing of identical products.

In the absence of pricing regulations, tobacco companies have been able to develop ways to blunt some of the public-health benefits of tobacco taxes by supplying lower-priced cigarettes to smokers who might otherwise quit following tax increases. Industry revenues lost through the sale of cheaper cigarettes have apparently been replaced by higher profits on more expensive brands. The constraints on retailer incentives implemented in Quebec in late 2016 do not appear to have ended cigarette price differentiation in that province.

What this paper adds

What is already known on this subject

- Raising cigarette prices through tobacco taxation is an effective tobacco control measure, but its power can be impacted by the pricing strategies of tobacco companies.

What important gaps in knowledge exist on this topic

- Despite the importance of cigarette prices, most tobacco control systems do not regularly monitor or report on tobacco product pricing.

What this paper adds

- Tobacco companies in Canada have developed retail programmes which help them influence the retail price of cigarettes at the neighbourhood level. Between-store differences in cigarette prices for the lowest-priced brands in Quebec were observed to be large enough to largely offset tax increases of the past decade.

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