

1 **Q. Dr. Krugman testified that it “defied logic” and his “experience” “to believe that the**
2 **cigarette industry has spent approximately \$12.5 billion on advertising and promotion in**
3 **2002 . . . only to market to their existing adult smokers” (Krugman Written Direct at p. 18,**
4 **lines 14-17). Do you agree with this opinion?**

5 A. First, as I’ll explain later, this \$12.5 billion figure is an artifact reflective of reporting
6 requirements unique to the tobacco industry. Second, in any event, it does not defy logic at all.
7 In the mature category, market competition is very intense and fewer companies are fighting for
8 a share of what is, in the case of cigarettes, a stagnant or even dwindling market. Despite this,
9 companies can still make sizeable profits if they can maintain their current loyal customer base,
10 while encouraging users of other brands to switch. It does not defy logic or experience, because
11 it is exactly what all manufacturers of mature products do -- whether it is television sets,
12 automobiles, laundry soap, toothpaste or cigarettes. Those other categories also spend as much
13 or more on advertising and promotion than the cigarette industry, as I discuss a bit later, so
14 obviously it makes a lot of sense.

15 **Q. You said advertising had different goals depending on the stage of the product life**
16 **cycle the product is in. Assuming we are talking about mature products like cigarettes, are**
17 **the goals of advertising immediate or more long-term?**

18 A. Advertising typically doesn’t have any immediate objectives, rather it is more properly
19 designed to attempt to create a long-term effect, most specifically an awareness of and
20 preference for the brand through the creation of an identifiable image for the brand and/or to
21 position the brand in the marketplace relative to its competition.

22 **Q. What is the key to good and effective advertising?**

1 A. The key is to create an identity for a brand, to always be consistent in promoting that
2 identity, either through advertising or promotion, and to create a look and feel around the
3 advertising so that it is clearly identifiable as advertising for that brand. The crucial effort is to
4 be consistent to the brand identity and attention-getting and, of course, to direct your advertising
5 message to the target audience already using the product category.

6 **Q. How does the marketer direct the advertising message to the target audience**
7 **already using the product category?**

8 A. Well, first and foremost the marketer must understand the market and product segments
9 that comprise that market.

10 **Q. In the case of cigarettes, what do you mean?**

11 A. The cigarette category market is made up of several different market segments, based on
12 product attributes. These segments tend not to compete with each other, although competition
13 within the product segments is quite fierce. In the case of cigarettes, there are *Premium Brands*,
14 namely those with the highest price and the highest profit margins. These cigarettes tend to be
15 the most heavily advertised because their profit margins support higher advertising expenditures.
16 Among the premium brands may be additional segments, such as menthol brands and “natural”
17 or “no additive” brands. Another segment of the cigarette market is the *Price or Value Brands*.
18 There is typically not much advertising for these brands, and what advertising there is focuses on
19 the value price of the brand rather than unique brand imagery. The cigarette market also
20 encompasses the *Low Tar and Ultra Low Tar Brands*. These brands deliver very different taste
21 and tar and nicotine delivery experiences for the smoker as compared to full flavored cigarettes
22 like Marlboro Red and, consumers in this segment are far more likely to switch to another brand

1 within this segment (say from Carlton to Merit Ultra Lights) than Marlboro Red. Of course,
2 there may also be premium low tar and value low tar brands. Understanding how your market is
3 segmented helps marketers direct their marketing dollars to consumers within the cigarette
4 market that are more likely to receive and respond to the marketing with a positive brand
5 decision.

6 **Q. How else would a marketer successfully direct his or her advertising message to the**
7 **target audience already using the product category?**

8 A. By engaging in market segmentation and target marketing.

9 **Q. Can you explain what you mean by “market segmentation” and “target**
10 **marketing”?**

11 A. Target marketing simply means identifying a specific segment of the market to be the
12 focal point for your marketing efforts. The target market is the group of people (or market
13 segment) who are most likely to respond favorably to what the marketer has to offer. (O’Guinn,
14 Allen & Semenik, *Advertising and Integrated Brand Promotion* (2003), p. 272, JD-012621.)
15 Target marketing is a standard marketing strategy that is employed by marketers of products and
16 services across all industries. There is nothing sinister or devious about this practice. In fact,
17 quite the contrary is true. Segmenting the market and directing advertising at a specific target
18 allow a firm to efficiently deploy limited resources in order to compete more effectively. By
19 segmenting the market and targeting certain customer groups, a firm can better understand
20 customer needs and provide brands that are more satisfying to the target market than
21 competitors’ brands. For example, the manufacturer of Kool, a premium menthol cigarette, is

likely to want to target smokers of premium menthol cigarettes, particularly leading competitors, such as Newport, in its advertising.

Q. Does targeting certain consumer groups have relevance to brands in mature product categories?

A. Yes. The need to segment the market and target consumer groups is particularly relevant to brands in mature product categories. Mature product categories are characterized by large numbers of competing brands offering a wide range of options for consumers. Further, consumers are highly knowledgeable about brands within mature product categories because they have long understood the features of the products within the category. Thus, companies need to develop brands with specific features so that a brand will find a segment of consumers who find it superior to competing brands.

Q. How does a marketer go about defining the target market for its marketing communication?

A. Target markets are based on consumer characteristics and behaviors. The marketer must study the market to determine the set of characteristics that best describe consumers of their brand. One cannot segment the market until he or she generally understands how and why consumers think, feel and behave the way they do about the particular product.

Q. How does a marketer go about tailoring the commercial communication to the target audience?

A. Research, research and more research. Ideas are tested on members of the target audience and refined to better suit them.

1 **Q. How does a marketer ascertain if the advertisement has appealed to the target**
2 **audience?**

3 A. More research. Marketers conduct pre-test and post-test focus groups, surveys, polls and
4 other studies to examine the potential impact of the brand message on the target audience.

5 **Q. Dr. Krugman identified these types of research undertaken: Strategic Research,**
6 **Consumer Research, Product Research, Market Analysis, Competitive Research and**
7 **Advertising Effectiveness Research (Pre-testing and Post-testing). Do you agree with that**
8 **list?**

9 A. I think that sums it up.

10 **Q. Dr. Krugman testified that with the exception of certain survey research, he was not**
11 **aware of any market research conducted by the Defendants in this case that was not**
12 **focused on smokers over the age of 18. Assuming Dr. Krugman is correct, how does that**
13 **comport with your opinion that cigarettes are marketed like other adult consumer**
14 **products?**

15 A. It is entirely consistent. I would expect that cigarette manufacturers would conduct
16 market research among *smokers*, because they are the consumers of the product, and they are the
17 target audience. Thus, one would want to know what smokers want in their brands, and what
18 brand attributes and images smokers -- or segments of smokers -- find appealing. I would also
19 expect such research to be conducted among adult smokers because it is an adult product, over
20 98% of cigarettes are sold to adults, and the competition is for the brand preference of adult
21 smokers.

1 **Q. Does the focus group research you just discussed play any role in your opinions you**
2 **discussed earlier regarding the imagery of cigarette ads?**

3 A. Yes it does. If the very cigarette ad executions discussed above are the result of
4 successful marketing research among adult smokers, then this marketing research confirms and
5 provides empirical evidence that supports my opinion that these images reflecting certain values
6 and norms are well-designed for the manufacturers' target audience -- adult smokers.

7 **Q. There have been some documents introduced into evidence in this case that discuss**
8 **demographic data, including the percentage of people under age 18 who smoke cigarettes.**
9 **Is that kind of information helpful in the target marketing process?**

10 A. Not really. Such data is more typically used to make sales forecasts and planning
11 decisions. For example, demographic data showing that more people are living in smaller family
12 units in nicer apartments and condominiums equipped with dishwashers could forecast a rise in
13 dishwasher detergent sales; or data on the aging population could forecast increased sales of
14 many products, such as Viagra. But such information is not very useful for developing product
15 imagery -- that's a little like asking the advertising agency for Honda to develop an advertising
16 campaign for the Honda Pilot by knowing how many people in the United States drive. This
17 information is not specific enough to inform marketers in any sort of a meaningful way.

18 **Q. Dr. Dolan testified that "tracking is not targeting" (Dolan Live Testimony at page**
19 **7830, line 24). Do you agree?**

20 A. I do. The American Association of Retired Persons no doubt tracks how many people are
21 coming of retirement age, some of which may at some point become interested in the products
22 and services they have to offer. That's not the same thing as targeting them.

1 **Q. You mentioned brand plans earlier. Have you reviewed certain brand plans that**
2 **admitted into evidence in this case.**

3 A. Yes, I have, and the brand plans I have reviewed are consistent with my opinion that
4 cigarette manufacturers are targeting adult smokers in an effort to impact their brand choice.

5 **Q. Are there any other ways that marketers have to target their advertising message?**

6 A. Another important way to target your advertising message is through advertising
7 placement. It is critical to place advertising where it is most likely to reach the audience that is
8 in the market for that product category – to get the most “bang” for the advertising “buck,” if you
9 will. This explains why one doesn’t find advertisements for golf clubs in *Glamour*, but might
10 find them in *Golf Digest*, or an airline magazine where businessmen and businesswomen who
11 play golf regularly might see the advertisement and be interested in reading it. It’s important to
12 identify the target audience and tailor the advertising placement to that audience.

13 **Q. Are you familiar with Dr. Krugman’s testimony that any magazine with more than**
14 **15% readers under the age of 18 is a “youth-oriented” magazine?**

15 A. I am, and I disagree with it.

16 **Q. Why?**

17 A. Because up to 85% of the readers of such magazines are adults, and every single one of
18 the magazines on his list is intended primarily for adults based on the editorial content and
19 predominance of other advertising for adult products. Magazines such as *Rolling Stone* and
20 *Sports Illustrated* are good vehicles to target smokers because they have tremendous reach -- that
21 is, they are read by a large number of adults. If the cigarette manufacturers have data, as

suggested in the examination of Dr. Krugman, that such magazines are “over-indexed” to smokers, then they are highly logical media to target adult smokers.

Q. What do you mean by “over-indexed”?

A. Most mass media audiences in the U.S. are carefully researched for various characteristics and then “indexed” for those characteristics, for ready comparison. Typically, an index of 100 means the audience is average, below 100 is below average, and above 100 is above average. Thus, *Sports Illustrated* will have an index well above 100 for male readership, whereas *Cosmopolitan* will have an index well above 100 for female readership. Many market research firms will provide indexes for smokers in those media where cigarettes are advertised. A magazine over-indexed for smokers will have a disproportionately high number of readers who are smokers, and cigarette advertisers all typically choose those publications to reach the target -- smokers.

Q. Are you familiar with the term “spillover”?

A. I am.

Q. What is “spillover” Dr. Semenik?

A. “Spillover” is essentially waste. These are the unintended recipients of an advertising communication, like people who see an advertisement but are not interested in the product category. Examples would include people who see a cute ad for a particular brand of cat food but don’t have cat, or an ad targeted at a demographic group -- say male senior citizens -- that is seen by persons outside of that group. Non-smokers certainly see ads for cigarettes, even though they are not the target.

1 **Q. How does a marketer avoid, or at least minimize “spillover”?**

2 A. Well, it’s important to remember that it is impossible to advertise in any mass media
3 vehicle, be it television, radio, newspapers, magazines, outdoor, etc. without encountering
4 spillover. One way to minimize spillover is to refocus marketing dollars away from mass media
5 advertising into more targeted promotional campaigns. To the extent a company does advertise
6 in mass media, it minimizes spillover by placing its ad in media that disproportionately reach its
7 intended target. Thus, the cat food ad would be in *Cat Fancy* magazine, and the ad aimed at
8 older males might air on a History Channel show about World War II.

9 **Q. In Dr. Krugman’s 2000 article entitled, “Teenage Exposure to Cigarette Advertising**
10 **in Popular Consumer Magazines,” he said, “a finding that teenagers are exposed to**
11 **cigarette advertisements in these current popular magazines does not demonstrate intent**
12 **on the part of the tobacco industry to reach such markets.” (U.S. Ex. 64,327, page 187) Do**
13 **you agree with this statement?**

14 A. Absolutely. Exposure in no way equates to targeting.

15 **Q. Wrapping up our specific discussion of advertising Dr. Semenik, can advertising**
16 **make people do things they don’t want to do, or buy things they don’t already want?**

17 A. No. This is an important point because people tend to think that advertising has profound
18 effects on *other people*. Looking at another issue advertisement from the American Association
19 of Advertising Agencies, JDEM-010332 (reprinted in Belch & Belch, *Advertising and*
20 *Promotion* (2004), p. 766), we see that association addressing this very issue:



DESPITE WHAT SOME PEOPLE THINK, ADVERTISING CAN'T MAKE YOU BUY SOMETHING YOU DON'T NEED.

Some people would have you believe that you are putty in the hands of every advertiser in the country.

They think that when advertising is put under your nose, your mind turns to oatmeal.

It's mass hypnosis. Subliminal seduction. Brain washing. Mind control. It's advertising.

And you are a pushover for it.

It explains why your kitchen cupboard is full of food you never eat.

Why your garage is full of cars you never drive.

Why your house is full of books you don't read, TV's you don't watch, beds you don't use, and clothes you don't wear.

You don't have a choice. You are forced to buy.

That's why this message is a cleverly disguised advertisement to get you to buy land in the tropics.

Got you again, didn't we? Send in your money.

ADVERTISING

ANOTHER WORD FOR FREEDOM OF CHOICE.
American Association of Advertising Agencies

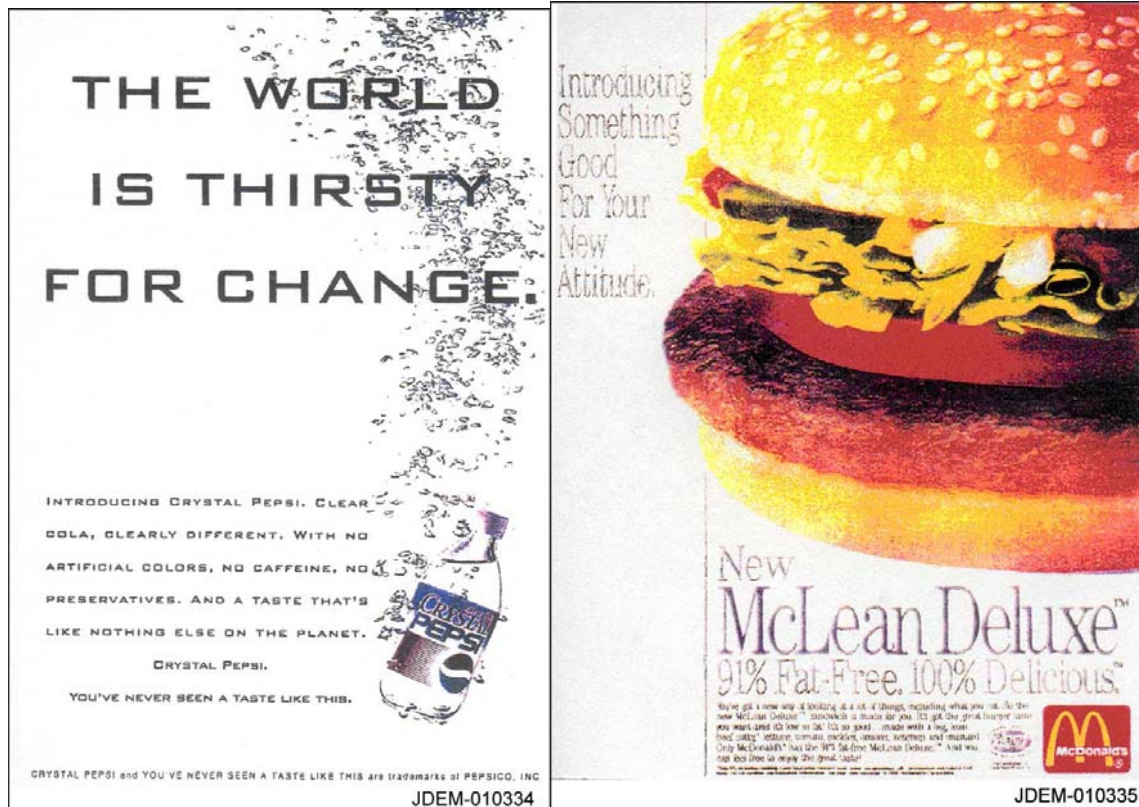
JDEM-010332

Needs are fundamental to human beings. They cannot be created by advertising tactics. As the authors of this text observe, "The reality is that consumers do have a choice and they are not being forced to buy. Persuasion, it can be argued, is very much a part of our lives, and consumers have the ability to ignore ads for products and services that they do not really need or that fail to interest them. (Belch & Belch, *Advertising and Promotion* (2004), p. 766)

Q. Does advertising have the power, by itself, to make a brand successful?

1 A. Advertising cannot do that either. All of the advertising in the world, by some of the
2 most creative, smart minds in the field could not make the Edsel a popular car, as shown in
3 JDEM-010333. Other examples of brands that failed despite having talented people and a lot of
4 money behind their advertising campaigns include McDonald's McLean Deluxe, JDEM-010335,
5 and Crystal Pepsi, JDEM-010334.





Regardless of the amount of advertising about a brand, that brand must still comport with consumer's preconceptions (cola is brown, burgers are juicy and tasty, and cars are not hideous) and it must deliver quality and a satisfying user experience. If the brand fails to do so., the brand or line extension will surely fail. Sometimes brands fail even when they do deliver on their promises.

VI. CIGARETTE SALES PROMOTION IS SIMILARLY FOCUSED ON IMPACTING BRAND AWARENESS AND BRAND CHOICE

Q. Let's turn to the issue of sales promotion. You stated that one of your opinions is that sales promotions are different from advertising.

A. That's correct.

1 **Q. Could you please distinguish between advertising and sales promotion for the**
2 **Court?**

3 A. Advertising and promotion are indeed separate aspects of marketing and marketing
4 strategy. Advertising is focused primarily on using mass media vehicles to communicate
5 messages about a product or service. Sales promotion includes a broad range of other activities:
6 direct marketing, sales promotions, premiums, giveaways, incentives to retailers, sales force
7 management and the like. Fifty years ago, advertising was the dominant means of creating
8 awareness and preference for a brand, but over time the marketplace has changed. Consumers
9 are bombarded with advertisements in mass media, and industry has responded with commercial
10 messages that are more tailored, or “targeted” if you will, to the particular audience that is
11 interested in their product. Promotions have become much more important, and a much more
12 dominant means of creating awareness and preference for a brand across all industries, including
13 cigarettes. As shown in JDEM-010326, taken from my book on advertising, the purposes of
14 advertising and promotion are also different, although both ultimately focus on brand sales.

Purposes of Sales Promotion and Advertising

Purpose of Sales Promotion	Purpose of Advertising
Stimulate short-term demand	Cultivate long-term demand
Encourage brand switching	Encourage brand loyalty
Induce trial use	Encourage repeat purchases
Promote price orientation	Promote image/ feature orientation
Obtain immediate, often measurable results	Obtain long-term effects, often difficult to measure

Source: JD-012621, chart 18.3 (p. 639)

JDEM-010326

Q. Do the same people create sales promotions and advertising for a given brand?

A. Not usually -- the personnel involved in advertising and promotion are often very different. Promotional activities are often handled by a specialized promotional group or department within a company, with advertising in a different department or handled by different personnel. Even when these activities are integrated at the top, different types of professionals handle them within an organization, and they involve different types of outside consulting firms.

Q. What has happened to the relationship between advertising and sales promotion in recent years?

1 A. As stated in my book on advertising, at p. 638, “[m]arketers have shifted the emphasis of
2 their promotional spending over the past decade. Most of the shift has been away from mass
3 media advertising and toward consumer and trade sales promotions.” (O’Guinn, Allen &
4 Semenik, *Advertising and Integrated Brand Promotion* (2003), p. 638, JD-012621) Dr.
5 Krugman said the same thing -- the “cigarette industry’s shift from traditional advertising to
6 promotion is reflective of a shift of such expenditures in business in general.” (Krugman Written
7 Direct at p. 30.) This shift has been greater in the area of consumer packaged goods. Mature
8 product categories, such as cigarettes, have seen intense promotional activity.

9 **Q. Why is the shift so marked with products in the mature category?**

10 A. In the mature stage of the product life cycle, as distinguished from the introductory or
11 growth stages, the goal of sales promotion is to increase awareness of the brand and maintain
12 brand loyalty while encouraging consumers of competitive brands to switch to your brand.

13 Again, sales promotion is not used to motivate consumers to use the product category in
14 the first instance. Rather, sales promotion is used to increase the volume of sales for a brand by
15 taking market share from competing brands. For example, Pepsi is currently running a
16 promotion where one can win a free song from iTunes by purchasing a Pepsi with a winning
17 bottle cap. That promotion is not likely to prompt someone to start drinking soda pop in the first
18 instance, but that person might choose Pepsi over Coke in the hopes of winning some free music
19 off of the internet.

20 **Q. Why not choose to drink soda to win that free song?**

21 A. Because it wouldn’t make sense. I can buy that song off the internet for \$.99. If I don’t
22 already like and buy soda, I would have to buy several sodas at a total cost of several dollars

1 before I am likely to win a song. If I'm already buying soda anyway, however, it doesn't cost
2 me anything extra and the promotion is an added bonus that rewards me for choosing that
3 particular brand. Another example would be frequent flyer miles that reward the customer for
4 using a particular airline. These perks don't convince me to fly in the first instance, but if I'm
5 going on a trip anyway, I may select a particular airline repeatedly to maximize my rewards.

6 **Q. What other tools does promotion include?**

7 A. Promotion includes a variety of tools used to develop brand awareness and brand loyalty
8 including coupons, sweepstakes, premiums, which are free giveaways – a free toothbrush with a
9 tube of toothpaste, for example – contests, dealer incentives, which means retailer incentives. It
10 is also fair to include personal selling in the area of promotion in its broadest definition.
11 Publicity can also be included in the area of promotion. In fact, it is reasonable to say that
12 promotion is everything other than advertising used by a firm in an attempt to develop preference
13 for its brands. However, promotion does not include the regular price charged for the product,
14 distribution, or product development, although they are parts of marketing.

15 **Q. What types of promotion are most effective at reaching brand switchers?**

16 A. Sales promotions which highlight price discounts, give-away premiums, or point-of-
17 purchase materials have become an increasingly important technique in encouraging brand
18 switching behavior. As a result, companies in a large number of different industries have shifted
19 dollars away from advertising and toward sales promotion. Sales promotions give a consumer a
20 reason to try a different brand by reducing the economic risk of trying that brand.

21 **Q. You testified that promotion does not include the price charged for the product but**
22 **that it does include price discounts. Can you explain this distinction in more detail?**

1 A. Temporary reductions in price in the form of a price promotion, like a retailer discount
2 that is passed along to the customer, coupons, or buy one get one free promotions do impact the
3 overall price the customer pays for that brand, but they are temporary and differ from the
4 situation where the company changes the regular price for the brand across the board.

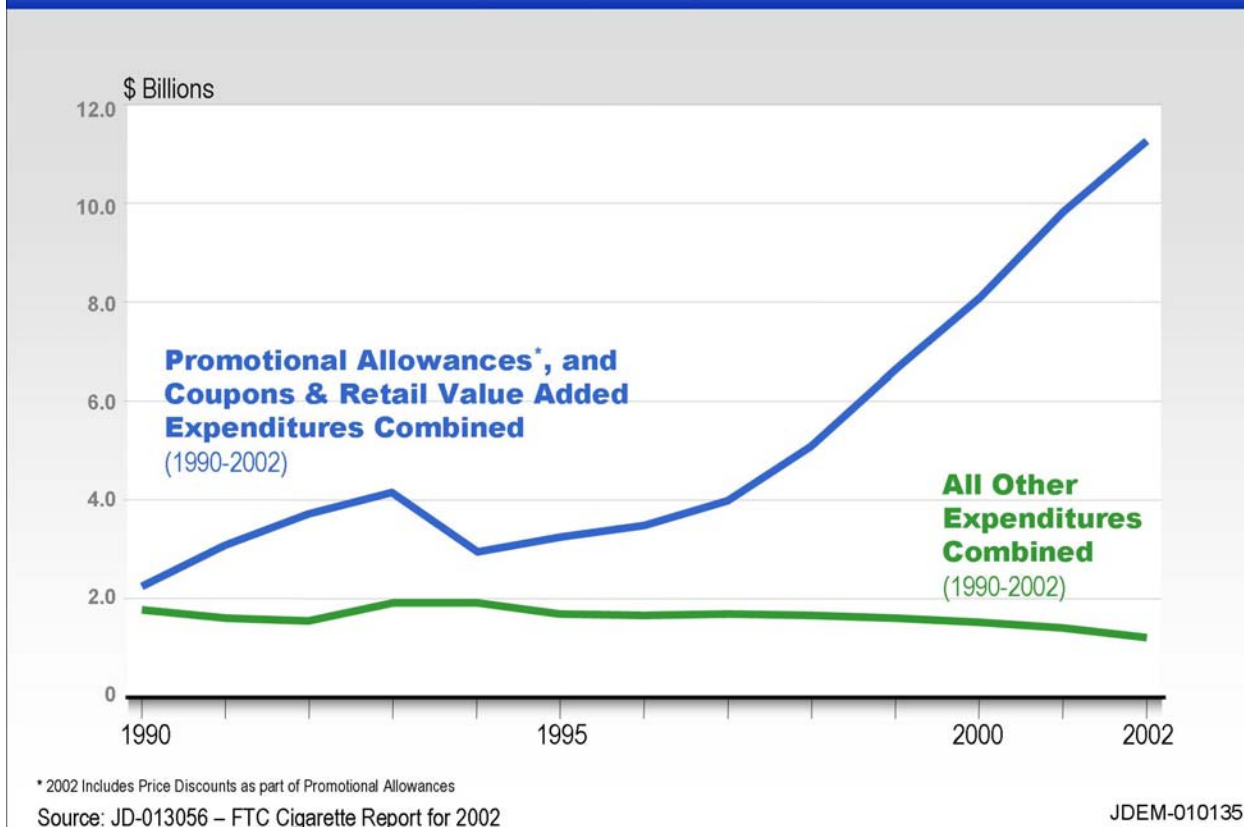
5 **Q. The Government's witnesses in this case have repeatedly stated, based on figures**
6 **reported by the FTC, that the tobacco industry spent more than \$12 billion on marketing**
7 **in 2002, and have questioned whether such a seemingly large expenditure could be solely**
8 **for the purpose of brand allocation within the market. How do you respond to that?**

9 A. Although this \$12.5 billion figure may be the figure reported by the FTC, it must be
10 placed in the proper context to be understood. The Government's witnesses' testimony failed to
11 reflect a thorough and conscientious examination of the unique reporting criteria imposed on the
12 tobacco industry by the FTC. I have prepared some charts to explain.

13 **Q. Can you explain the first chart, which is JDEM-010135?**

Cigarette Advertising Spending

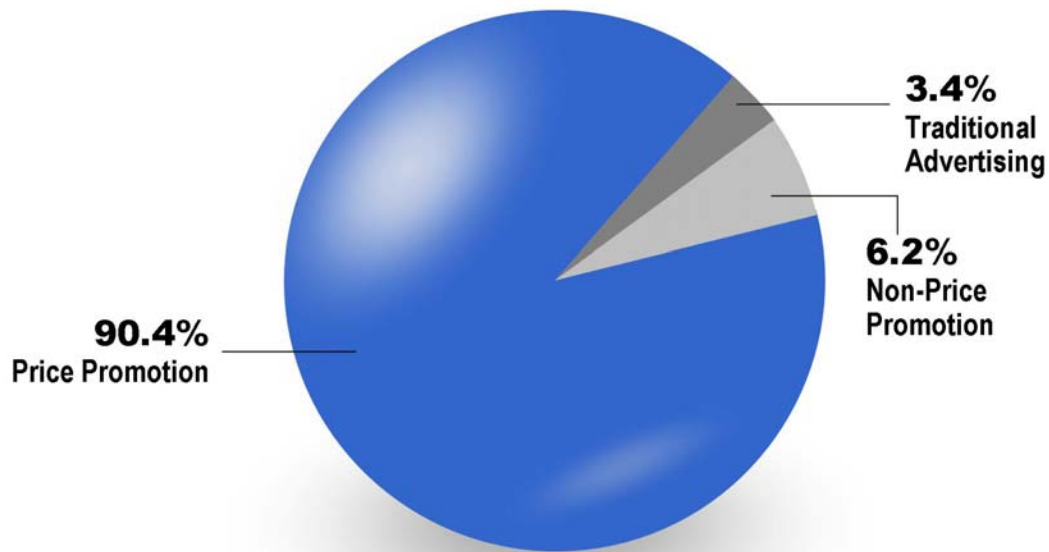
Federal Trade Commission Reported Spending



A. Yes. This chart is based on data taken directly out of the FTC's report on 2002 marketing expenditures for cigarettes. All we did is categorize the expenditures between price promotions and all other expenditures. As you can see, apart from price promotions, expenditures have been flat over the past decade -- and have even declined on an absolute basis -- whereas price promotional expenditures have increased dramatically. This is consistent with the general pattern shift in marketing toward more price promotion.

Q. What is the next chart, which is JDEM-010325?

The Overwhelming Majority of Cigarette Industry Marketing Expenditures Are Related to Price



Source: JD-013056: 2004 FTC Report for 2002 Cigarette Marketing Expenditures

JDEM-010325

A. This is a pie chart showing the different categories of promotional “spending.” I put “spending” in quotations for a reason I will explain in a moment. On this pie chart, the blue portion -- 90% -- represents promotional activities that relate to price -- *e.g.*, coupons, cents-off, retailer buy-downs, etc. The light gray shaded items -- 6.2% -- are non-price promotions, such as direct mail costs. The remaining dark gray section is traditional advertising costs. What you see here is that most of the money “spent” on promotion goes to price, retailer, and wholesaler incentives.

Q. Can you explain what activities make up the blue portion of this chart?

1 A. The overwhelming majority of cigarette marketing dollars in 2002 were spent on price
2 discounts paid to cigarette retailers or wholesalers (in order to reduce the price of cigarettes to
3 customers) with what they call “off-invoice discounts,” buy-downs, voluntary price reductions
4 and trade programs, which accounted for 63.2% of expenditures reported to the FTC. In
5 addition, promotional allowances to retailers(used to facilitate the sale and/or placement of
6 cigarette brands including but not limited to volume rebates and incentive payments) totaled
7 10.7%; promotional allowances to wholesalers like volume rebates, incentive payments and
8 value added services totaled 3.6%; retail value added expenditures for promotions involving free
9 cigarettes (like buy one get one free promotions) or non-cigarette items (buy one pack, get one
10 free lighter promotions) totaled 8.7%; and coupons targeted to and redeemed by smokers totaled
11 4.2%. These promotional expenditures total 90.4% of all the cigarette industry’s marketing
12 expenditures (or \$11.3 billion of the \$12.5 billion), and they all essentially relate to price.

13 **Q. Why is it significant that most of these FTC-reported expenditures are on price**
14 **promotions?**

15 A. For several reasons. First, price promotions have virtually no spillover to non-smokers.
16 They are only relevant to a smoker, whose calculus becomes “my brand is now more expensive
17 than this competitor -- should I try the competitor instead?” Somebody without a dishwasher
18 will not buy dishwasher detergent because of a price promotion; likewise, a non-smoker is not
19 going to buy Marlboro simply because it is 20 cents off.

20 Second, when a manufacturer temporarily lowers its price, whether with a coupon or a
21 price promotion, it has not really “spent” anything. Instead, it has foregone some of the profit it
22 could have earned if it could sell the product at the higher price. In many instances, the

1 manufacturer expects to sell more units and gain market share at the expense of its competitor.
2 In these circumstances, the manufacturer is not really out of pocket in terms of spending.
3 Indeed, if more units are sold, profits may *increase*.

4 Finally, with cigarettes, it is clear that prices have climbed dramatically in recent years.
5 If the price of a product doubles, but price promotional activity stays *proportionately* the same,
6 then it would appear that the money “spent” on such promotions has doubled when it really has
7 not. For example, if a pack of cigarettes costs \$2.00 and the average price promotion is 10
8 percent, under the FTC accounting, the manufacturer has “spent” 20 cents per pack. If the price
9 goes to \$4.00 per pack, and promotional activity stays at 10 percent, the manufacturer has now
10 “spent” 40 cents a pack. The consumer, who is now really spending twice as much, is hardly
11 comforted by the “doubling” in promotional activity.

12 In the end, the “increase” in cigarette marketing “spending” in recent years, as reported
13 by the FTC, reflects little more than the fact that cigarettes cost a lot more. The underlying non-
14 price advertising and promotional components have been quite stable.

15 **Q. What does this mean in terms of the Government’s claim that Defendants have**
16 **vastly increased their marketing of cigarettes in recent years?**

17 A. That claim is skewed by the unique and unusual manner in which the FTC requires
18 reporting of cigarette marketing expenditures. Other industries do not report marketing data this
19 way. If you look underneath the FTC numbers, the industry is spending less on advertising, and
20 spending moderately more on highly targeted promotions, such as direct mail. Again, the
21 Government’s experts’ testimony failed to reflect this unique circumstance with respect to
22 reporting price discounts.

1 **Q. What do you mean that other industries do not report marketing expenditures this**
2 **way?**

3 A. To take an example, hotels almost never charge the “rack rate” for an overnight stay in
4 one of their hotel rooms. Instead, there are various promotions available through travel agents,
5 reservation lines, on the internet, and through rewards programs associated with particular hotel
6 chains. These companies do not count the difference between the rack rate and the actual
7 amount charged as a promotional expense, but instead as a revenue loss. If the Starwood Hotels
8 company was required to report its marketing expenditures to the FTC in the same manner as the
9 cigarette industry, it might appear as if this company is spending more money on promotional
10 expenditures than the company made over the course of a year because they routinely offer such
11 steep discounts off their regular rates. The same goes for airlines. Similarly, auto companies
12 have all kinds of dealer incentives, rebates and other price related promotions that undoubtedly
13 dwarf their advertising expenditures. The end result is that the \$12 billion figure is vastly
14 inflated compared to the way firms in other industries report their advertising and promotional
15 spending. For example, if the automobile industry had to report its expenditures in the same
16 way, they would likely be at least several times greater than the \$16 billion currently reported.

17 **Q. What would happen if the cigarette manufacturers simply lowered their prices?**

18 A. Well, if they did that, the amounts viewed by the FTC as promotional expenditures would
19 drop dramatically.

20 **Q. Why don’t cigarette companies regularly just lower their prices?**

21 A. There are a number of reasons why companies, including cigarette manufacturers, do not
22 routinely lower their prices, but instead offer promotional discounts of limited duration. First,

1 there are some consumers who can and will pay premium prices when necessary – like the
2 businesswoman buying a last minute ticket on an airplane and hotel room booking for a business
3 trip. For these consumers, there is no reason for the company to forego premium revenue, so
4 companies keep their premium rates stable. Others want that better rate and are willing and able
5 to jump through more hoops to get it, like a Saturday night stay or nonrefundable purchase. The
6 second reason is more psychological: many companies want their brands to be seen as premium,
7 quality brands and their regular price must reflect this image. If a brand always costs less than
8 other brands, consumers will probably start perceiving that brand to be inferior to other brands.
9 It also helps to have some consumers feel they are getting a special “deal” on a quality, premium
10 brand that not all others are enjoying, much like that discounted rate for Marriott Reward
11 Members, which makes those consumers feel special and rewarded, encouraging loyalty into the
12 future. Finally, promotions can be targeted so that the price is reduced in only a certain location,
13 or type of store. For example, Philip Morris might do a Marlboro promotion in convenience
14 stores in Boston to counter a similar Winston promotion, but charge full price in other outlets
15 and other cities.

16 **Q. Is there anything unique about cigarette manufacturers’ decision to utilize price**
17 **promotions rather than simply lowering their prices?**

18 A. No, they utilize price promotions for the same reason manufacturers of all mature
19 products do -- to maintain and build market share. However, for these other companies, their
20 lost revenue resulting from these discounts are treated as such, whereas the cigarette companies’
21 lost revenue is treated by the FTC as a promotional expense, which inflates their expenditures in
22 this category.

1 **Q. Does the cost of price promotions differ from the cost of advertising?**

2 A. Absolutely. With advertising, the money spent on an advertising campaign, the shoot,
3 the production, the placement, the distribution, is not recoverable regardless of the success or
4 failure of the campaign. If I create an advertisement for perfume and place it in women's
5 magazines, but the ad does not resonate with my consumer target and does not lead to increased
6 brand awareness and sales of my brand down the line, I cannot recoup my expenditures on that
7 advertising. Price promotions, on the other hand, are a marginal cost. Promotions cost the
8 company more as more consumers utilize and redeem those promotional offers. If I offer a \$.40
9 coupon on Marlboros and 1,000,000 coupons are redeemed, that "costs" me less than if
10 10,000,000 coupons are redeemed. I still hope that more coupons are redeemed despite the
11 "cost" because it means I have sold more of my brand as a result of that coupon promotion.

12 **Q. Are you familiar with "Marlboro Friday?"**

13 A. I am.

14 **Q. What was "Marlboro Friday?"**

15 A. Marlboro Friday refers to the date April 2, 1993, when Philip Morris announced the
16 launch of a major price promotion, designed to effect a 20% reduction in Marlboro's price,
17 effectively lowering the average price per pack to consumers by \$.40.

18 **Q. Did Philip Morris reduce the list price of Marlboros?**

19 A. Not in the beginning. It cut net retail prices through the use of coupons and other
20 consumer promotions, such as "buy three, get two free" promotions.

21 **Q. Was "Marlboro Friday" a newsworthy event?**

1 A. It was, largely because it was so unusual -- at least back then -- for a premium cigarette
2 brand, especially the leading cigarette brand, to reduce the cost of its premium brand to the
3 consumer so aggressively and dramatically. The event was covered in the lay press, like the *New*
4 *York Times*, as well as publications geared to the marketing industry like *Advertising Age*. In
5 fact, in one story in *Advertising Age* about Marlboro's price reduction the author observed:

6 Philip Morris (and presumably other premium tobacco brand marketers) are
7 simply reacting to a sobering reality: *their industry category has reached maturity*
8 *in the product life cycle*. During this stage, it's not unusual for marketers to cut
9 prices and introduce other consumer inducements to squeeze as much life as
10 possible out of the aging product category before it becomes either no longer
11 profitable to sell, or is legislated out of the marketplace.

12 ("Don't Count Premium Brands Out Yet," *Advertising Age* (April 12, 1993) (emphasis added)).

13 **Q. Did "Marlboro Friday" have an impact on the entire cigarette industry?**

14 A. It did, because in July, 1993, Philip Morris converted the price promotions into an
15 equivalent list price reduction and applied it to all of Philip Morris' premium brands including
16 Virginia Slims, Benson & Hedges, Merit and Parliament. Further, other companies, including
17 the company with second largest market share, R.J. Reynolds, followed suit with price cuts on
18 their brands.

19 **Q. Can you see the impact of Philip Morris' permanent price reduction in the FTC**
20 **Reports to Congress regarding cigarette industry advertising and promotional**
21 **expenditures?**

22 A. Most definitely. If you examine the FTC data for 1993 and 1994 for promotional
23 allowances, coupons and retail value added, you see a dramatic rise in 1993, to \$4.1 billion,
24 caused by the huge price promotional expenditures, followed by a precipitous drop in these
25 categories to \$2.9 billion in 1994, caused by the promotional price decrease being made

1 permanent, and other companies following suit. If Philip Morris had never decided to make
2 these promotional price reductions permanent through an actual price cut, and had other Philip
3 Morris and other company brands not followed suit, this drop in promotional expenditures would
4 not have occurred. Yet, from the consumer standpoint, the effect was about the same -- the cost
5 of premium cigarettes such as Marlboro and Winston declined by \$.40/pack.

6 **Q. By the way Dr. Semenik, did Philip Morris' strategy to regain market share from**
7 **threatening value brands succeed?**

8 A. It did. In 1992, Marlboro's market share had fallen below 25%, while the market share
9 of value brands had risen to over 30%. In 1994, after Marlboro Friday and the company's
10 decision to make those price promotions permanent through price reductions, the market share of
11 value brands fell and Marlboro's market share once again rose to 30%. This situation
12 demonstrates the earlier discussion of how firms need to compete in mature markets. (*See*
13 *generally* Semenik & Bamossy, *Principles of Marketing: A Global Perspective* (1994), p. 242,
14 JD-012478.)

15 **Q. What's the bottom line with respect to \$12 billion in cigarette marketing?**

16 A. This is mostly an artifact of rapidly increasing cigarette prices and intense price
17 competition. The underlying spending on traditional advertising and non-price promotions is
18 stable or even declining. The FTC data certainly cannot be used to say that cigarette
19 manufacturers have somehow vastly "increased" their marketing to attract new smokers, even if
20 that was possible.

VII. CIGARETTE MARKETING EXPENDITURES ARE NOT OUT OF STEP WITH OTHER INDUSTRIES

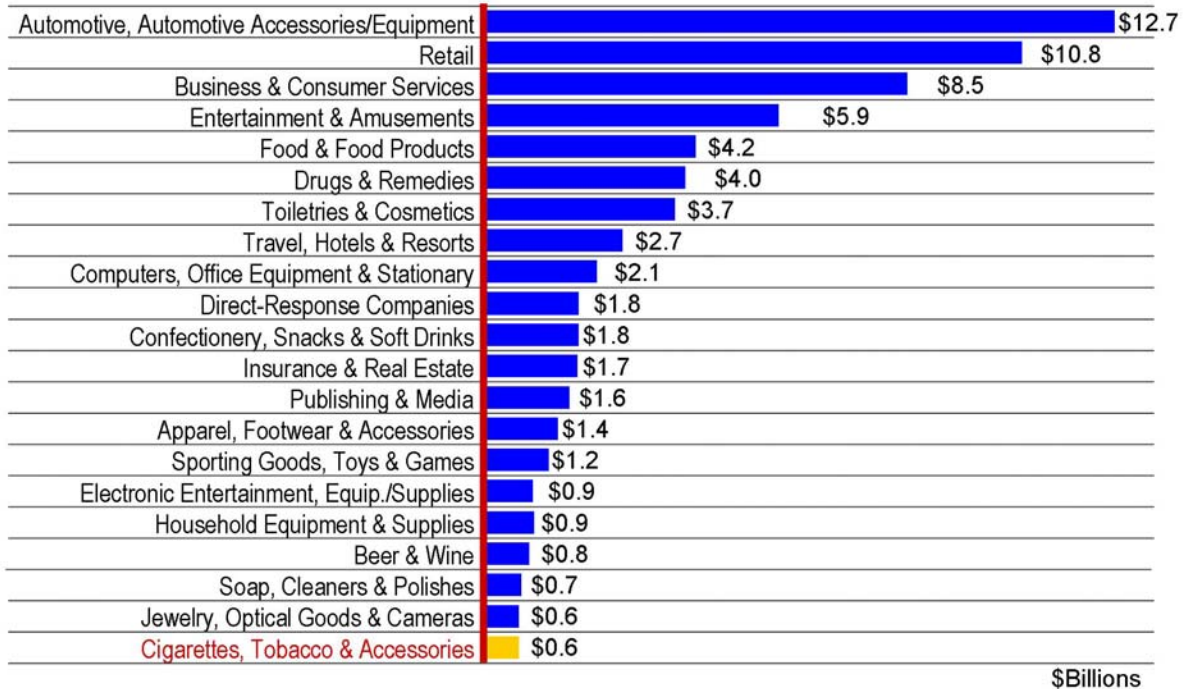
Q. Let's talk about your next opinion, which is that cigarette marketing expenditures are comparable to those for other similar products. What data is available?

A. There is a wealth of data on *advertising* expenditures for various industries and products. Such data is readily obtainable and comparable, because it generally captures spending in "measured media," *i.e.*, television, radio, magazines, newspapers, billboards. In contrast, there is little data on total promotional spending, particularly the price aspect, and the data that is available is difficult to compare.

Q. What does the data on advertising show with respect to cigarettes compared to other products?

A. Data from Leading National Advertisers shows that total cigarette advertising expenditures are quite low relative to the advertising expenditures of other product and service categories. For example, in this snapshot from 1997 (JDEM-010336), before the Master Settlement Agreement, cigarette advertising expenditures in all media were about \$600 million, as compared with automotive at \$12.7 billion.

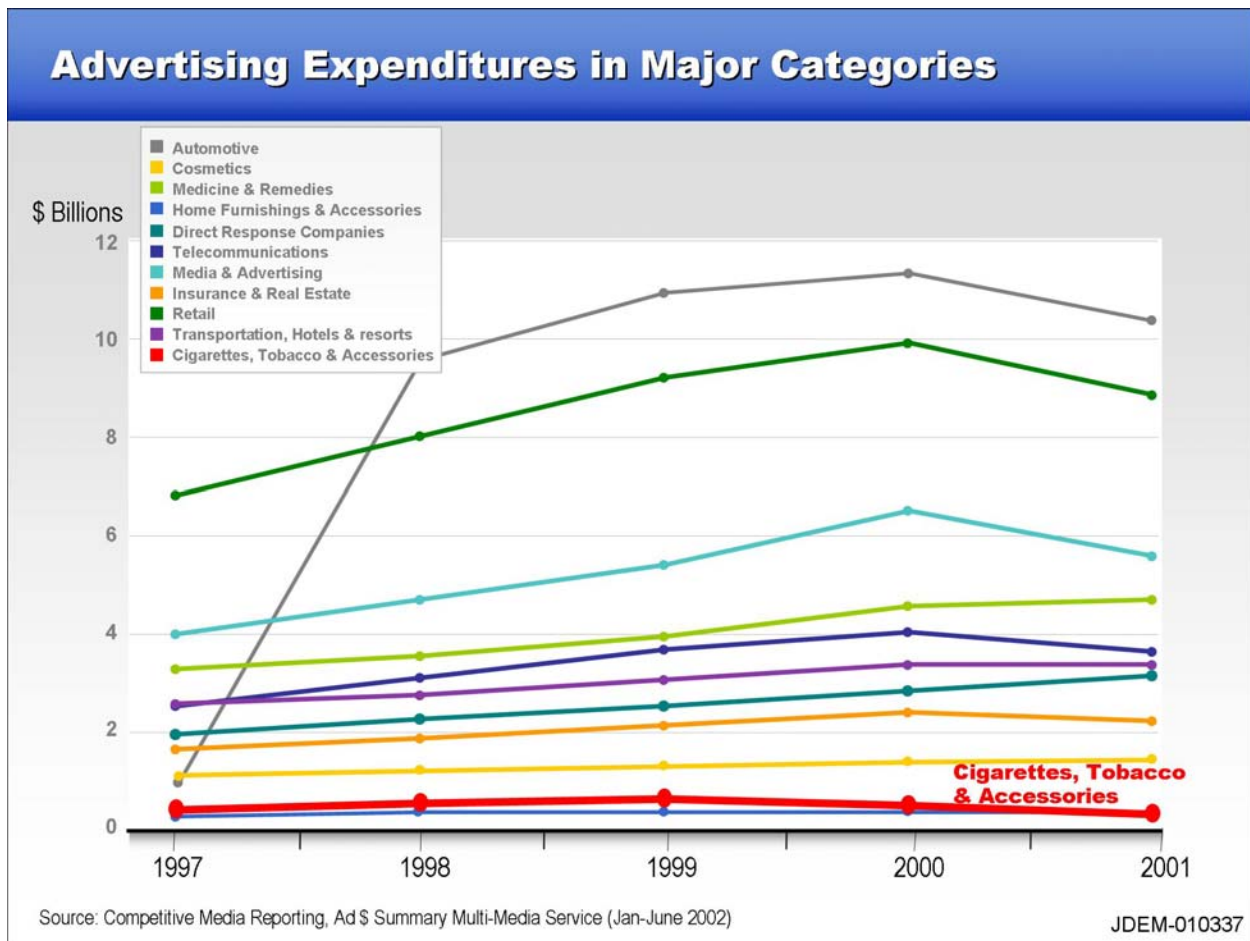
U.S. Advertising Expenditures - 1997



Source: Competitive Media Reporting, LNA/MediaWatch Service Ad \$ Summary (Jan-Dec. 1997) JDEM-010336

Q. Have you examined this LNA data over time, since the MSA went into effect?

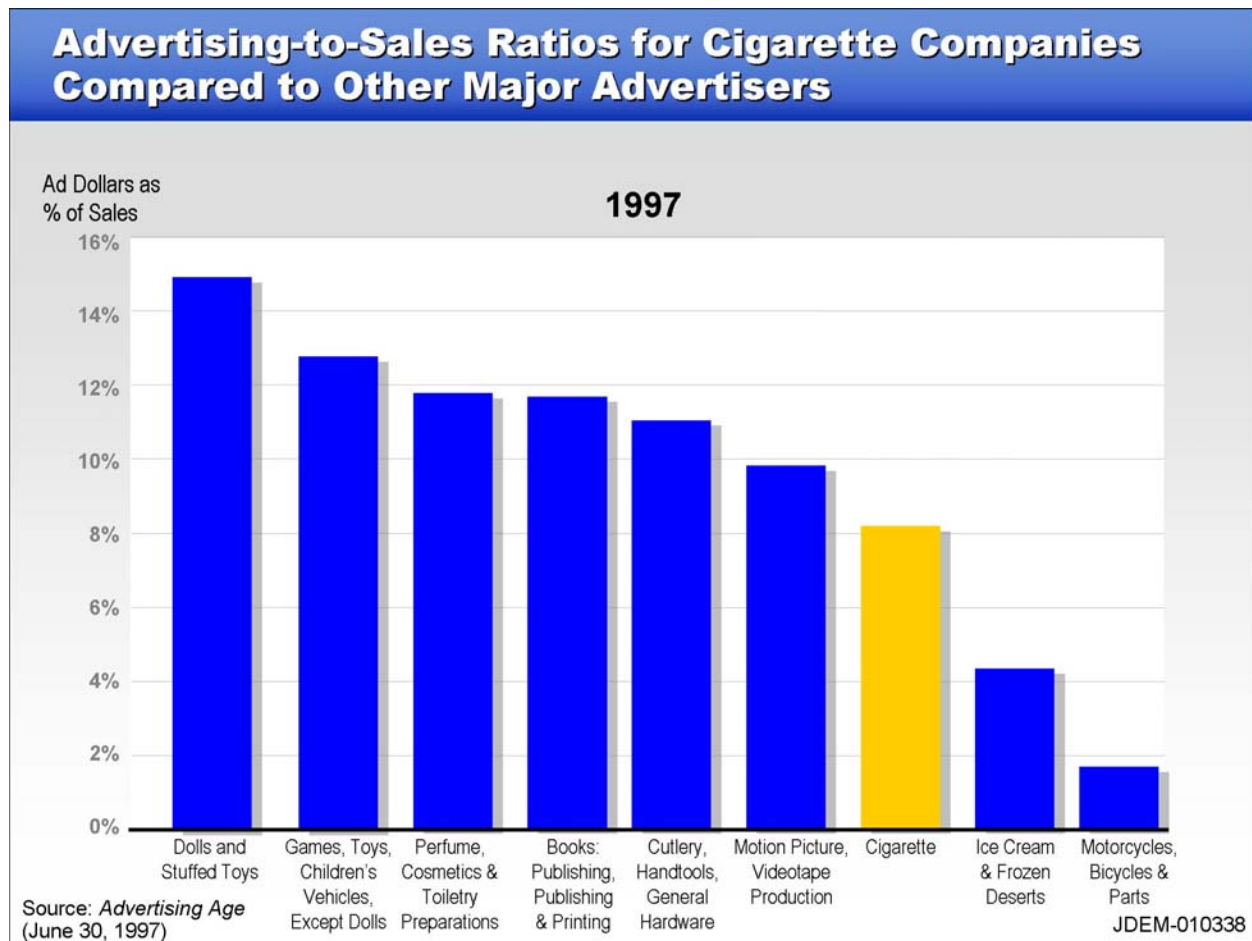
A. I have and it shows that cigarette advertising expenditures are quite low and quite flat relative to other industries. (JDEM-010337)



Q. Are there other ways of comparing industries in terms of how much they spend on advertising?

A. Another way would be to compare advertising-to-sales ratios for various industries.

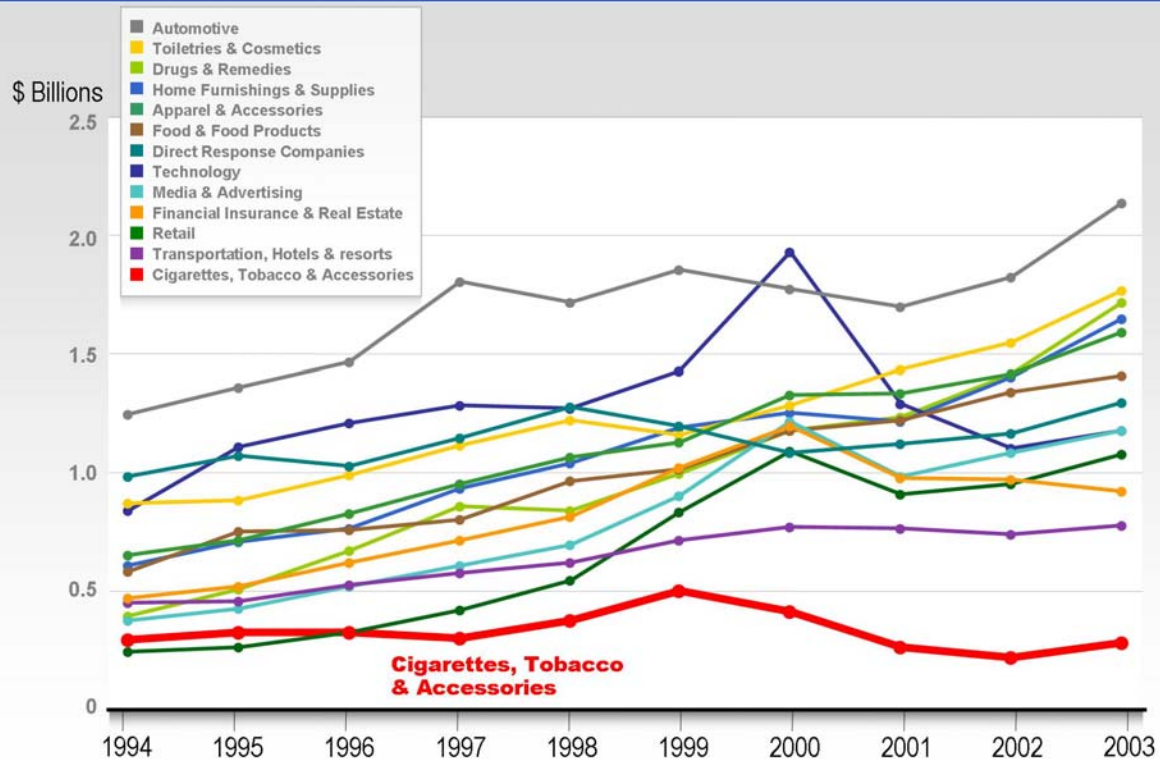
Again, just looking at the snapshot of 1997 (JDEM-010338), you can see that the category of cigarettes was spending a smaller proportion of their sales on advertising than general hardware, perfume, games, dolls and stuffed toys.



Q. The Government has suggested that, after the MSA was signed in 1998, the tobacco industry simply shifted money from prohibited activities, such as billboards, to other media, particularly magazines. Is that true?

A. No. JDEM-010150 looks at advertising expenditures in magazines, one of the last commercial media still used by some cigarette manufacturers to advertise their brands, as tracked by the Magazine Publishers of America based on CMR/TNS data, the same data source used by Dr. Krugman for much of his testimony on magazines.

Advertising Expenditures in Major Categories



Source: Magazine Publishers of America based on CMR/TNS data

JDEM-010150

This exhibit clearly demonstrates that, relative to other major product categories, cigarette advertising expenditures in magazines are low over the nine-year period from 1994-2003, while expenditures for categories like automotive, toiletries and cosmetics drop and remedies, home furnishings and supplies, apparel and accessories, food and food products, direct response companies, technology, media and advertising, financial insurance and real estate, retail, transportation, and hotels and resorts are all higher than cigarettes and increasing. While there was a temporary increase in magazine advertising for cigarettes in 1999, expenditures soon reverted to historical levels, which are low and flat.

Q. Has cigarette advertising increased overall -- not just in magazines -- since the Master Settlement Agreement in 1998?

A. It has not. In fact it has declined proportionate to other branded products. In 1997, Marlboro was the only cigarette brand that placed in the top 100 “Megabrands” as reported by *Advertising Age* based on measured media spending (JDEM-010339). Marlboro came in at number 71, below the U.S. Postal Service.

Megabrands Ranked by 1997 Measured Media Spending	
Rank	Brand, Product or Service
1	Sears Stores
2	Chevrolet Cars & Trucks
3	McDonald’s Restaurants
6	AT&T Telephone Svcs.
10	Circuit City Stores
15	American Express Credit Cards
20	General Mills Cereals
21	Tylenol Remedies
38	Home Depot Stores
43	L’Oréal Haircare & Cosmetics
49	Montgomery Ward Stores
54	Mattel Toys
60	U.S. Postal Service
71	Marlboro Cigarettes

Source: *Advertising Age* (July 13, 1998) JDEM-010339

In 1999, Marlboro, the only cigarette brand in that year’s Megabrand list had fallen to 148 in ranked media, below Hallmark Cards at 128. In 2003, there was not a single cigarette brand in the top 200. Interestingly, however, the highest cigarette-related ranking that year was for Philip Morris’ youth anti-smoking campaign which was ranked 200 in 2003 according to *Brandweek*

Magazine as shown in JDEM-010188. The “Truth” anti-smoking campaign also ranked higher than any cigarette brand.



America's Top 2000 Brands

Cigarette Brand Advertising

Rank 2003	Brand	Total measured ad spending 2003
403	Camel Cigarettes	\$35,906.10
622	Winston Cigarettes	\$26,111.90
843	Quest Light Cigarettes	\$20,554.40
880	Salem Menthol Cigarettes	\$19,887.70
969	Pall Mall Cigarettes	\$18,224.10
1916	Newport Menthol Cigarettes	\$ 9,301.30

Youth Smoking Prevention Advertising

Rank 2003	Brand	Total measured ad spending 2003
200	Philip Morris Cos Inc Public Service	\$62,190.20
246	Truth About Smoking	\$52,901.20

Source: JD-013105

JDEM-010188

VIII. CIGARETTE ADVERTISING IMAGES DO NOT UNDERMINE HEALTH INFORMATION ABOUT SMOKING

Q. Let's turn to another of your opinions, which concerns the impact of cigarette advertising on information concerning the health risks of smoking. Do positive images in cigarette advertising undermine beliefs concerning the negative consequences of smoking that people receive from wide and varied sources of information?

1 A. I do not think so. For the reasons I have previously explained, cigarette advertising and
2 the images they contain are aimed at the brand level. They distinguish brands from one another
3 rather than addressing the attributes of the cigarette product category as a whole.

4 **Q. Cigarette advertisements feature positive images don't they?**

5 A. Sure they do, but so does advertising for every other product and service on the planet.
6 Survey research spanning 60 years shows that adolescents and adults alike have received the
7 message from a wide range of credible sources that cigarette smoking can be dangerous to health
8 and cigarette advertising does nothing to change this.

9 **Q. What specific research supports your conclusion?**

10 A. As far back as 1932, in a survey of 7th to 12th graders, 73 percent of boys and 76 percent
11 of girls believed that smoking was harmful to students. (Whitlow, "The Prevalence of Smoking
12 and Drinking Among High School Pupils," *School and Society* (1932)), JD-012383) In a 1959
13 nationwide survey of 10,763 high school students undertaken by *Senior Scholastic*, JD-012362,
14 97.4 percent said they believed there was some connection between smoking and lung cancer. In
15 1977, Gallup's nationwide poll of teenagers, JD-012297, revealed that 96 percent believed
16 smoking to be bad for one's health prompting George Gallup himself to conclude, "Efforts to
17 convince America's teenagers of the dangers of smoking apparently have been successful."

18 **Q. Are you aware that cigarette advertisements in the 1940s and early 1950s made**
19 **references to health?**

20 A. I am, and the FTC stopped those sorts of advertising appeals with new FTC Guidelines in
21 1955 – fifty years ago.

1 **Q. Would those ads have undermined the negative health messages the public was**
2 **receiving from credible sources about cigarettes?**

3 A. No. Again, these appeals were competitive and aimed at the brand level. They amounted
4 to communications like, “our brand won’t hurt your throat” and “our brand won’t make you feel
5 bad the next day” and “our brand doesn’t cause coughs.” This is classic negative advertising
6 which serves to reinforce the health concerns that already predominate. In fact, the business
7 press -- *Fortune Magazine*, *Business Week* and others -- expressed criticism of the cigarette
8 industry’s use of medical themes because the industry was effectively reminding consumers of
9 the health issues related to cigarette use that were already receiving such widespread attention in
10 the media. (“The Uproar in Cigarettes,” *Fortune* (Dec. 1953), JD-012366; “What Has Hit
11 Tobacco Stocks,” *Business Week* (Nov. 21, 1953), JD-012381)

12 **Q. Dr. Krugman testified repeatedly that certain kinds of cigarette advertising are**
13 **“ubiquitous.” Does what some call the “ubiquity” of cigarette advertising undermine**
14 **people’s understanding of the risks associated with smoking?**

15 A. No. In the first place, as we’ve already discussed, cigarette advertising is far from
16 ubiquitous. Less than five percent of cigarette marketing expenditures are spent on traditional
17 advertising, as opposed to price promotions and seller incentives. Cigarette advertising has not
18 appeared on television or radio for 35 years. Even during the days of broadcast cigarette
19 advertising, it never represented more than about 2-3 percent of all advertising expenditures.
20 Today, not a single cigarette brand appears in the *Advertising Age* annual list of the 200 most
21 advertised brands, JD-062132. Even where cigarette advertising does appear, you have the issue
22 of “clutter” that we discussed earlier. Advertising for all sorts of branded products surround us

1 every day. Cigarette advertising can hardly be considered “ubiquitous” in this sea of advertising
2 for cars, cosmetics, electronics, apparel, food products and travel services, just to name a few. A
3 person’s perception of the “ubiquity” of smoking is much more likely to be influenced by
4 whether his or her peers and family members smoke. A person exposed to few smokers is not
5 likely to view smoking as ubiquitous based on advertising. A person surrounded by family and
6 friends who do smoke may perceive smoking as widespread regardless of any exposure to
7 advertising.

8 **IX. CORPORATE ADVOCACY ADVERTISING IS NOT PRIMARILY TARGETED AT**
9 **THE CONSUMER**

10 **Q. Now let’s turn briefly to your final opinion, concerning the impact and intent of**
11 **corporate advocacy advertising. How does advocacy advertising differ from the kind of**
12 **advertising we have been talking about?**

13 A. The distinguishing feature of advocacy advertising is that it is not designed to directly or
14 immediately influence consumer brand choice. It is aimed at promoting a firm or industry’s
15 position on an important social or political issue. (Semenik, *Promotion and Integrated*
16 *Marketing Communications* (2002) pp. 466-68, JD-012371; O’Guinn, Allen & Semenik,
17 *Advertising and Integrated Brand Promotion* (2003), p. 712, JD-012621) As such, this type of
18 advertising is usually targeted much differently -- directed toward opinion leaders, politicians,
19 commentators and others who shape public policy. Thus, it would not be unusual for an
20 advocacy ad to appear in the *New York Times*, *Washington Post*, or *Time* magazine (or if a local
21 issue, in the leading local newspaper), but it would be unusual for it to be placed in popular
22 magazines such as *Glamour*, *People* or *Sports Illustrated*.

1 **Q. Have you reviewed some of the tobacco advocacy advertising introduced in this**
2 **case?**

3 A. I have, for example, Philip Morris's "Facts You Should Know," U.S. Ex. 20,371.

4 **Q. To whom does that advertising appear to be directed?**

5 A. The general public and opinion leaders, rather than smokers themselves. The messages
6 are very broad and the vehicles in which these advertisements have been placed (*New York*
7 *Times, Wall Street Journal*) do not appear targeted to consumers of the product.

8 **Q. Thank you, Dr. Semenik.**