THE PROBLEMS OF MONOPOLY AND OLIGOPOLY IN THE

AMERICAN TOBACCO INDUSTRY

by

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CHAPTER I

A History of Tobacco and The Tobacco Industry to 1900

Nicotiana rustica and Nicotiana tabacum are plants indigenous to Central and South America and Nicotiana rustica is to be found in North America along with Nicotiana tabacum which various Indian tribes had brought with them in their northward migrations.

Tobacco had been used by the Indians for hundreds of years on the new continent prior to the landing of such explorers as Columbus, Amerigo Vespucci, Cabral, Cortez and Alarcon; what is more every form of tobacco consumption was utilized such as pipe, cigar, cigarette, snuff and chewing tobacco.

Cabral observed the Tupinambas of Brazil as follows:

> "They carry a calabash made like the head of a man, with mouth, nostrils, eyes and hair, placed on the top of an arrow, within which they make smoke with dried leaves of the plant betum, and the smoke which is in the head they inhale to such an extent that they are drunk."(1)

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(1) Heimann, Robert K., Tobacco and Americans, (McGraw-Hill 1960), p. 9.

Many of the early explorers looked upon the use of tobacco as a heathen custom and overlooked its future economic value in their lust for gold. The educated Spaniard despised the brown, unbaptised Indian and was slow to understand his custom of smoking and chewing tobacco; therefore, he threw away the brown leaf and searched for golden treasure and it was not for some period of time that the economic value of tobacco was first brought to light.

The first group of people to realize the value of tobacco were the sailors, Spanish, Dutch, and Portuguese, and Nicotiana tabacum moved to Spain where it was utilized in the early 1500's. Its use spread then to England, Switzerland, Greece, and Italy; while the death penalty was imposed in Russia, Turkey, Persia and India for its early use.

Early trade in tobacco during the first half of the sixteenth century was carried on by the Spaniards and it was they who spread the use of tobacco to England and the Continent.

Sir Walter Raleigh was credited with the introduction of the uses of tobacco in the Courts of England and he was content to receive most of his tobacco from the Spaniards up to the time of the defeat of the Spanish Armada. Tobacco was being produced at this time in North America as John Rolfe had sent a shipment from Jamestown in 1613, which was not the first tobacco to come from the New World. This Virginia tobacco was a thick fibered, powerful product, Nicotiana rustica, cultivated by Rolfe and his wife, Pocahontas, and was an improvement of the native strains which were most prevalent in Virginia.(2)

Sir Walter Raleigh did much to popularize the use of tobacco in England, and it may have been due in part to this practice that he was beheaded by the great tobacco hater James I of England.

James I was the first major obstacle of the Virginia and North American Continent tobacco industry as he was heard to say, "and now good countrymen, let us consider, what honour or policies can move us to imitate the barbarous and beastly manners of the wild, godless and slavish Indians, especially in so vile and stinking a custome? Why do we not as well imitate them in walking naked as they do?"(3)

It was under the reign of James I that the first tobacco taxes which now are an important expense of the tobacco industry were imposed, and motivated by hatred for Raleigh and the Spanish, James I raised the import duty in 1604 from tupence per pound to six shillings tenpence, a boost of 4,000 percent; however, trade in Spanish and Virginia leaf flourished and this high tax lead to smuggling and cultivation of tobacco in England proper.

John Rolfe and his wife, Pocahontas, were leaders in the development of plantations of tobacco in Virginia and were

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(2) American Tobacco Company, Sold American, Copyright 1954 p. 10.

(3) Ibid., p. 11.

instrumental in a switch from Nicotiana rustica to Nicotiana tabacum as this plant was much more acceptable and much more in demand in the markets of England.

In the Virginia colony and elsewhere in the New World tobacco leaf was used as legal tender and for the payment of wages, debts, and taxes. It was the greatest single source of wealth of Virginia, Maryland and North Carolina until early in the 1800's when tobacco was over taken by "King Cotton" as the principal source of agriculture income.

Despite the view of King James I and the high tariff the tobacco industry expanded rapidly in London and by 1614 there were 7,000 shops selling tobacco. In 1617 Virginia shipped 20,000 pounds to England, in 1628, 500,000 pounds, in 1638 1,400,000 pounds and by 1771 England and Scotland had annual imports of 102,000,000 pounds between them, virtually all from the Chesapeake colonies.

Having given up their search for gold the English land companies set about the further development of tobacco in the colonies and by preferential treatment, as regarded the tariff, excluded Spanish trade and encouraged the Virginia Company in whatever ways were possible.(4)

In the Virginia Company a diversification of industry was encouraged and farmers planted and harvested a corn crop as well

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(4) Heiman, Robert K., Tobacco and Americans, (McGraw-Hill 1960), p. 50.

as tobacco. Fishing, lumbering, ship building, iron and glass works all were subsidized from 1608 onward; however, in 1621 the practice of raising funds by lottery was abandoned and the Virginia Company died of financial malnutrition and tobacco growing was further emphasized.

Captain John Smith estimated that a man was worth up to 50 pounds sterling a year if engaged in growing tobacco as against 10 pounds sterling if he devoted his time to a corn crop. Tobacco required less cleared ground and less shipping space than any other crop, and this was another reason for its cultivation.[5]

Tobacco played an important economic part in the American Revolution, as Virginia leaf was used to pay for war material. In 1776 General George Washington appealed to his countrymen, "I say, if you can't send money, send tobacco."[6]

The British seemed as eager to kill tobacco plants as they did the blue-coated revolutionaries, and the campaign waged by Phillips and Arnold in the Old Dominion later was termed the "Tobacco War".

One of the principal causes of the War of Independence was the economic yoke of Great Britain. British merchantmen received goods on consignment for the colonists and for their payment

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(5) American Tobacco Company, Sold American, Copyright 1954 p. 12.

(6) Ibid., p. 12.

transported leaf tobacco to England. Due to usurous rates of interest incurred in their credit arrangements the planters debts rose to huge proportions as all manufactured goods for the most part were imported from England, this being the only market available to the planters. When the planter became burdened with debt, he lost his individual freedom of trade and had to accept for his tobacco products whatever price was offered. This was an intolerable situation for the tidewater planters and was one principal reason for the Revolutionary War.(7)

The debt relationship which existed between the British merchantmen and the tidewater planters was the principal reason that great numbers of emigrants departed from Virginia to relocate in Kentucky, Indiana and Ohio. The result of this emigration was that tobacco crops were developed in this area and transported in hogshead to New Orleans via the Mississippi River for export to France and the continent of Europe.

Tobacco was grown in the new England colonies as well, and was a principal source of income to the inhabitants of that area, which was a leader in the development of tobacco for the cigar industry following the Revolutionary War. The settlers did not look with complete approval on the use of

(7) Heimann, Robert K., Tobacco and Americans, (McGraw-Hill 1960), p. 61.

tobacco; however, a stringy type of tobacco was produced. Production of tobacco increased in the New England area from 540,000 pounds in 1830 to 9,300,000 pounds in 1859.(8)

The two principal grades of tobacco leaf that were used in the latter half of the 19th century were burley which is characterized as thick and rather dark in its final cured form and bright leaf which is a product of both culture and cure. In 1839 an eighteen year old negro of the Slade Farm in Caswell County, just south of Danville, Virginia was curing leaf in a barn heated by wood fires. When the fires were almost burned out, he fed them with charcoal ordinarily reserved for the blacksmithy, since the wood pile was soaked by rain. Under the renewed blast of heat supplied by the charcoal, Styphans' leaf "kep' on yallown' and kep' on yallown' and kep' on yallown". It also sold for 40 cents a pound as against the average price of 10 cents and this leaf yellow in color was classified as bright.(9)

Burley and Bright tobacco constituted the principal ingredents used in cigarette making prior to the 1900's when Turkish tobacco was imported and blended with native tobaccos resulting in a product that had great popularity, and a pleasing aroma and taste.

In the 1800's purchase of tobacco was usually made directly from the farmers and the large tobacco plantations of Virginia

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(8) Ibid., p. 84.

(9) Ibid., p. 150.

and the farms of Maryland, North Carolina and Kentucky. The tobacco was compressed into hogsheads and with the exception of a few producers, who had good reputations and produced a good product, led to the packing of inferior and stemmy leaf in the middle of the barrel, and the sanding of the product as a general practice. Sanding is the process of mixing dirt and foreign element with the market product to increase its weight. Warehousing and auction sale of leaf by baskets of approximately 100 pounds was an innovation of the 20th century.

Thus, tobacco can be traced to the period before October 12, 1492 when Christopher Columbus put in at San Salvador and the Spanish sailors were introduced to the brown leaf. Next the use of tobacco spread to Spain and from there to the European Continent and England. It was encouraged by some rules and prohibited by others with taxes and death decrees for its use. The French and English courts popularized snuff and jeweled snuff boxes, Spain used cigars and cigarettes, the English and Continentals adopted the use of pipes and the English and American sailors and the backwoodsman, farmers, and plainsmen favored the use of chewing tobacco. It was not until the latter part of the 19th century that the Dukes and their contemporaries popularized the machine made cigarettes which were to expand into one of the leading industries of the United States during the 20th century.

The Dukes were one of the first families to develop a tobacco product for commercial use and sale. In addition, they played an important role in the development of the cigarette industry.

CHAPTER II

James Buchanan Duke and the Development of the American Tobacco Company

James B. Duke was perhaps the most important single individual in the development and expansion of the tobacco industry. From a humble beginning he developed into an empire builder in the tobacco industry and in public utilities.

After a successful career in industry he engaged in various philanthropies among which was the endowment to Duke University in Durham, North Carolina which aided in the founding and growth of this great school.

Between the extremes of a log house birthplace and Duke Chapel which marked the beginning and end of an exceptional and creative life passed the founder of the American Tobacco Company and tobacco "Trust".(1)

James Buchanan Duke known as "Buck" Duke in the tobacco industry was born December 23, 1856, the son of W. Duke and Artelia Rony Duke. His mother died when he was twenty months old, and his father raised him to manhood. He had a normal

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(1) Rankin, Walter S. Dr., James Buchanan Duke (1856-1925) A Great Pattern of Hardwork, Wisdom and Benevolence, (The Newcomer Society in North America 1952) pp. 7 and 8.

childhood and at the age of nine, at the end of the Civil War, he was hard at work on his father's war-torn farm near Durham, North Carolina. His father had been released from a North Carolina prison in 1865 and had returned to Durham and the 300 acre farm that had been ransacked by Federal troops. Little was left of value outside of some cured tobacco leaf which the elder Duke processed and labeled "Pro Bono Publico" and which he traded for staples at nearby Raleigh.

In 1866 W. Duke Sons and Company turned out 15,000 pounds of products which was sold for 30 to 40 cents per pound after revenue taxes, netting them about $5,000. Five years later the Dukes were still together in their own Durham factory, a small affair on Main Street, but their brand, Duke of Durham, was no match for W. T. Blackwells' Bull Durham, and James B. Duke decided to travel to New York and enter the cigarette industry at some future time.(2) James Duke left Durham for New York twelve years later, at the age of twenty seven, with a total capital of somewhat less than $100,000 which he was to use to expand the Durham holdings.

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(2) American Tobacco Company, Sold American, Copyright 1954 p. 19.

In 1880 a Virginian by the name of James Bonsack succeeded in inventing an automatic machine called the Bonsack machine, and in 1884 James Duke installed two of them in the factory of W. Duke and Sons at Durham. A young machinist by the name of William O'Brien improved the performance of these machines, making them economically feasible.

On June 11, 1885 James Duke signed a secret contract with the Bonsack Company, in which he agreed to use the machine for fine rolled work which consisted of rolling and packing each individual cigarette. The rough work of sorting and cutting the tobacco was to be done on the Bonsack machine as well.(3)

His royalty rate was to be 24 cents per thousand. The arrangement was to be permanent so long as the agreement was not disclosed and his fine work was completed on the machines. This was a reduction of 6 cents to 10 cents from a standard fee of 30 cents per thousand, and a later clause guaranteed

(3) Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven Connecticut 1950) p. 21.

that Duke's royalty payments should always be 25 per cent less than the standard rental charged his competitors.[4]

With the improvements that were made by William O'Brien, an employee of Duke, the Bonsack machines were able to turn out 200 cigarettes a minute. This rate of production is low compared to today's top speed of 1,600 and "cruising speed" of 1,300 per minute, but was a remarkable accomplishment at this time.[5]

Although Duke's use of machinery was soon followed by others he had obtained the first important advantage over his competitors who used hand rolled cigarettes in production.

Duke had the advantage of the best type of machine, made available on better terms than anyone else could obtain. Against Allen and Ginter and his other competitors he had a royalty differentiation which could be used to further the sale of his cigarettes by a price reduction or by increased sales effort.[6]

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(4) American Tobacco Company, Sold American, Copyright 1954 p. 19.

(5) Ibid., p. 19.

(6) Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 21.

The Bonsack machine was not the sole explanation of Duke's success, but as to his agreement, he was forced to sue in order to get the 25 per cent guaranteed royalty advantage. Duke possessed commercial genius which he utilized in selling tobacco products, as he was one of the first tobacco executives who successfully used advertisements, premiums and coupons in the promotion of his product.

During the first two years of production of Duke of Durham cigarettes, business was slow as there was a high tax on the product per 1,000 cigarettes. In March 1883 the tax was reduced to 50 cents per 1,000 cigarettes to become effective as of May 1 of that year, and Duke cut the price of his product by 50 per cent. Dealers were induced to replace their inventories with Duke of Durham cigarettes by delivery concessions, and 30 million cigarettes were sold during a nine month period. This was a signal victory over competitors.(7)

Duke had taken care of mechanization successfully and he turned to other matters such as prices and profit. He narrowed his profit margin in anticipation of increased sales, as The Duke of Durham cigarettes were sold for 5 cents compared with the standard price of 10 cents. This was made

(7) Ibid., p. 22.

possible by the tax reduction from $1.75 to 50 cents per 1,000 cigarettes, and dealer delivery concessions. These delivery concessions were agreements by the dealers to take delivery of cigarettes so that the distributor could take advantage of the tax reduction. Given choice leaf, efficient manufacture and the right price only the problem of advertising remained for Duke.[8]

Duke's sales chief, Richard H. Wright, embarked on a world tour in order to promote the sale of Duke of Durham cigarettes, traveling to Europe, Africa, India, Australia and New Zealand. He met with continued success in the promotion of his product.

In 1884, Duke established a loft factory on Rivington Street in New York City, where he produced a number of cigarette brands including Cameo, Cross Cut, and Duke's Best. He spent heavily on advertising in the form of newspapers and billboard displays, also on photographs of actresses or redeemable coupons which were used as a means of inducing sales.

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(8) American Tobacco Company, Sold American, Copyright 1954 p. 20.

The success of Duke's salesmanship led to the change in 1885 of the partnership of W. Duke Sons and Company to a corporation with capital assets of $250,000. Duke increased selling pressure by various means and cut prices to distributors as a result of saving in production costs and increased operating profits. Aggressive methods insured success in both Durham and New York and by 1889 Duke was the largest manufacturer in the country.(9)

In 1889 the value of sales for W. Duke Sons and Co. was $45 million dollars and the annual rate of profit was $400,000. The major expense of the company was in advertising outlay which in the long run was responsible for increased income as it resulted in a positive shift of the demand curve for cigarettes. Demand for cigarettes was somewhat inelastic, and was influenced favorably by advertising.

As for price policies during the period after the Civil War to 1900, the major companies priced their product in 5 cent units, and Duke was the offeror of the best buy of 10 Duke of Durham cigarettes for 5 cents, whereas his principal competitors offered the same quantity for 10 cents.

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(9) Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) pp. 23 and 24.

Duke's battle for control over the cigarette industry was aided by complacency on the part of his competitors. The three basic elements of monopolistic competition; price, product differentation, and advertising, were not given proper attention by his business rivals.[10]

In the formative years of the cigarette industry between 1850 and 1900 there were several large and rapidly growing companies which had more capital at their disposal than Duke. One of the major competitors is reported to have said of Duke, "We don't consider him a manufacturer of cigarettes; he will be broke before the year is out".[11]

Duke knew exactly what he wished to accomplish and as early as 1887 made overtures to several of the leading companies in regard to merger. In 1889 the Kinney Tobacco Company was willing to talk terms but Lewis Ginter of Allen and Ginter told Duke that he didn't have enough money to buy them out and he would not negotiate.

Duke continued to apply pressure all along the line, and in 1890 his major competitors being unable and unwilling to

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(10) Chamberlin, Edward Hastings, <u>The Theory of Monopolistic Competition</u>, (Harvard University Press, Cambridge, Massachusetts 1960), p. 71.

(11) Tennant, Richard B., <u>The American Cigarette Industry</u>, (Yale University Press, New Haven, Connecticut 1950) p. 24.

TABLE I

CIGARETTE SALES OF FIVE PRINCIPAL MANUFACTURERS, 1889

Company	Millions of Cigarettes
W. Duke Sons and Company	834
Allen and Ginter	517
Kinney Tobacco Company	432
William S. Kimball and Company	237
Goodwin and Company	168

SOURCE: Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 24.

match his aggressive tactics, formed a corporation which was to be known as the American Tobacco Company of which James B. Duke became president.

The American Tobacco Company was incorporated in the State of New Jersey with an authorized capital of $15 million dollars in common stock and $10 million dollars in 8% non-cumulative preferred stock, for a combined total of $25 million dollars. This stock was assigned respectively to the firms of W. Duke Sons and Company, Allen and Ginter, Kinney Tobacco Company, William S. Kimball and Company and Goodwin and Company in proportion to the record of past earnings and projected future prospects of each company. The Dukes received total assets of $7.5 million dollars; however, this figure is somewhat misleading for the total tangible assets of the "Trust" which were expected to equal $5 million dollars only amounted to $3.2 million dollars and the resultant deficiency was made up of notes of the individual stockholders. This is an example of "watered" stock as the asset position was overstated. Despite this shaky organizational structure, American Tobacco Company earned more than $4 million dollars a year for the five succeeding years.[12]

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(12) Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 26.

For the first few years of its operation, American Tobacco Co. concentrated on the manufacture of cigarettes. Under James Duke's direction, the base of operation was expanded to include all the principal lines of tobacco. Monopoly status was reached for all products with the exception of cigars, the limiting factor being the wide diversification of production due to hand rolling techniques utilized in their manufacture.

In addition to cigarette manufacture, American had diversified interests in other phases of the business such as cigar and cigarette machinery, licorice paste, box manufacture and box making machinery. It also had an extensive holding in retail tobacco stores and foreign plants producing tobacco for other countries.

The American Tobacco Company was at first a holding company for the Continental Tobacco Company and the Consolidated Tobacco Company; however, as a result of the Federal Court's decision in the Northern Securities Case in 1904, the directors of American decided to consolidate by merger to avoid possible government disfavor.

Under James Duke's direction this powerful corporation used the same business tactics that had proved so successful in the cigarette industry to increase its market position as regarded the other tobacco products. Price, advertising and product differentation were controlled or emphasized.

In 1891 the American Tobacco Company increased its capital structure to $35 million dollars with a new issue of $6 million dollars in common stock and $4 million dollars of preferred stock. This additional funding was used extensively in the acquisition of rival companies, a principal example being the National Tobacco Works of Louisville, Kentucky. American used one of this companies plug products, "Battle Ax", as a fighting brand with competitors and operated on the following principle: prices of the plug were cut sharply resulting in a net loss for this product which was covered by the profits from cigarettes. The principal competitors were P. Lorillard Company of Jersey City and Liggett and Myers Tobacco Company of St. Louis, and with the increased pressure from competition these two companies were absorbed by the "Trust" in 1898.

Conquest of all the tobacco products was accomplished in much the same manner as by the plug wars. The "Trust" captured control of all of the basic products with the exception of cigars in the so called tobacco wars of the late nineteenth century.[13]

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(13) Ibid., pp. 28 and 31.

TABLE 2

TRUST SHARE OF THE NATIONAL OUTPUT OF
TOBACCO PRODUCTS, 1910

Product	Percentage
Cigarettes	86.1
Plug	84.9
Smoking	76.2
Fine Cut	79.7
Snuff	96.5
Little Cigars	91.4
Cigars	14.4

SOURCE: Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 27.

In the fall of 1901 the American Tobacco Company invaded the English market by buying control of Ogden's, Limited, a leading manufacturer of tobacco products, and Duke's pattern of cut prices, advertising and extravagant deals to jobbers was utilized. In retaliation, thirteen of the major British manufacturers combined to form the Imperial Tobacco Company which waged a successful price war with Ogden's. In addition the public was encouraged to boycott American Tobacco Company products. The dispute was settled by selling Ogden's Limited to Imperial in exchange for Imperial securities.

With the conclusion of the tobacco wars the physical structure of the "Trust" was nearly complete, although control of the many branches of manufacture continued to increase through acquisition of minor companies and the further expansion of the business. Further absorption of related industries such as licorice paste, tin foil, cotton bags for tobacco, wooden boxes, machine construction and repair and retail stores was accomplished.(14)

Ginter, Kinney, Kimball and Emery disposed of most of their holdings in American Tobacco and in their place two

(14) Ibid., pp. 32 and 33.

TABLE 3

TRUST SALES OF AND LOSSES ON PLUG AND PROFITS

ON CIGARETTES, 1894-1898

Year	Plug Sales Millions of Pounds	Plug Losses Thousands of Dollars	Cigarette Profits Thousands of Dollars
1894	9	-110 (gain)	3,529
1895	20	913	3,530
1896	31	1,378	3,290
1897	38	890	2,886
1898	33	942	2,690

SOURCE: Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 29.

financiers, Oliver H. Payne and H. L. Terrell, who had invested heavily in American Tobacco stock during 1897 and 1898, were put on the board of directors. Other financiers acquired large holdings of "Trust" stock, and the company was reorganized as a result.

The stock of the tobacco trust was backed by assets of which 55% was good will; therefore, it was "watered" stock as the assets were overvalued. In 1908, just a few years after reorganization, earnings were $28.7 million or 12.6% return on capitalization, and common stock earnings equalled 46.1% indicating an effective financial structure.(15)

The American Tobacco Company acquired monopoly over the domestic tobacco market and was the chief exporter of tobacco and tobacco products to foreign countries.

R. H. Wright, the chief of sales for American, succeeded in capturing nearly 100% of foreign exports and his counterpart James B. Duke maintained effective control of the market

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(15) Ibid., pp. 36-38.

at home. Large selling campaigns and superior capital structure aided in the commercial struggle with competitors.

The combination also brought control of cigarette machinery; for in addition to the Bonsack of American, Kinney brought with him the rights to the Allison machines and Goodwin brought into the corporation the Emery machine. Patent rights to the De Coufle cigarette machine, a French invention, were purchased in 1892 for $250,000.

The "Trust" manufactured nearly all of the popular cigarette brands, chief among them being Sweet Caporal which accounted for half of the cigarette consumption in 1898. The advertising outlay of American was such that it did not cut too sharply into profits, but was instrumental in keeping out the entry of competitors, and aided in the sale of "Trust" products.(16) James B. Duke and his associates resorted to quite a variety of acts which were effective in discouraging competition. The "Trust" pirated competitor's labor force,

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(16) Ibid., pp. 41 and 42.

TABLE 4

COMPOSITION OF TRUST ASSETS

(BOOK VALUE), 1908

Class of Assets	Million of Dollars
Domestic tobacco business	
Tangible Assets	$118
Goodwill	148
Total	$266
Foreign tobacco business	30
Domestic companies other than tobacco manufacturers	5
Miscellaneous loans and deposits	25
	$326

SOURCE: Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 36.

RATIO OF EARNINGS TO TANGIBLE ASSETS AND NET SALES DOMESTIC TRUST BUSINESS 1890 -1910

CHART 1

OURCE: Tennant, Richard B., The American Cigarette Industry, p. 38.

disrupted the leaf markets and even used spies in the rival work forces to interrupt productive efficiency.

The use of Turkish tobacco after 1900 reduced the percentage control of the market; however, Duke and American bought Turkish tobacco and blended it with burley and bright, competing with Piedmont which captured the lead in cigarette sales from Sweet Caporal.

There were several independent companies producing Turkish tobacco, and S. Anargyros, a Greek, imported Egyptian Dieties; which were a major source of competition until 1899 when American Tobacco purchased his business for $450,000. Several other Turkish products were eliminated from competition by the same method.(17)

Cigarettes were sold in units of 10, 20, 50, or 100 as required by internal revenue law, and the general price policy was to make sales in 5¢ units; however, about 1900 policy was changed to that which would permit sales in odd penny lots and this improved the "Trust" sales and profit position.

This combination had a virtual monopoly of the cigarette industry and control approaching monopoly on all other forms

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(17) *Ibid.*, pp. 49 and 50.

of tobacco with the exception of regular sized cigars. In 1889 these five companies had produced 2,188 million cigarettes or 91.7% of the total national output of 2,413 million.[18]

With the formation of the American Tobacco Company the monopoly position was established and the "Trust" had unchallanged leadership and control of the entire American tobacco industry.

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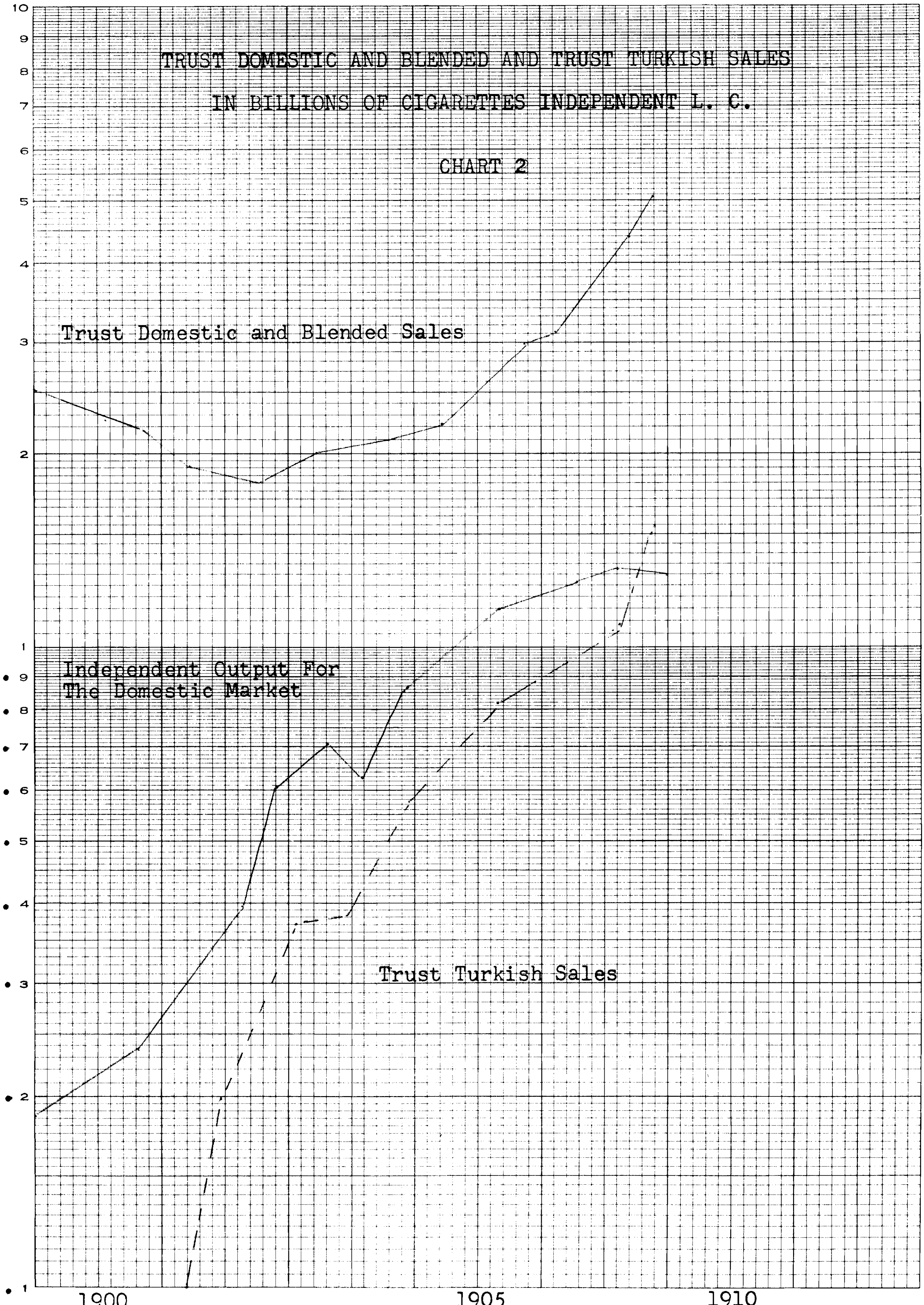
(18) Ibid., p. 25.



)URCE: Tennant, Richard B., The American Cigarette Industry, p. 47.

CHAPTER III

The Sherman and Clayton Anti-Trust Acts and Dissolution of the Tobacco Trust

The first anti-trust act to be passed by the Federal Government was the Sherman Act which was enacted on July 2, 1890 and its purpose was to protect trade and commerce against unalwful restraints.(1)

The complete Sherman Act contains eight sections; however, in applying this legislation against the tobacco industry sections one and two were utilized. Section one states that the formation of a trust or any other combination in restraint of trade is clearly illegal and section two states that monopoly or attempts to monopolize is a violation of the act. Maximum penalty for the violation of either of these sections is a fine not to exceed fifty thousand dollars or imprisonment not to exceed one year and both of these punishments may be levied for one offense, at the discretion of the court.

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(1) Commerce Clearing House, Labor Law Course 1962, Twelfth Edition, p. 7141.

The language of this act is clear enough to spell out the offenses which it covers, but there is wide latitude afforded the court in its interpretation and application of the law. In the cases brought against the major companies of the tobacco industry new ground was broken as this act was given very liberal interpretation by the courts.

To summarize section one it can be said that any conspiracy in the form of a trust or other organization in restraint of trade is illegal and punishable by fine, imprisonment or both. Section two states that any attempt to monopolize or any monopoly is clearly illegal and punishable by fine, imprisonment or both.[2]

The Sherman Act was the legislation with which the government prosecutor filed charges against the "Trust" as early as 1907 and which culminated in the dissolution of the "Trust" in 1911. The American Tobacco Company was prosecuted for violation of Sections one and two of the Sherman Act. They clearly violated the stated rules embodied therein, and this was proved conclusively by the assistant attorney general McReynolds.

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(2) Ibid., pp. 7141-7142.

On October 15, 1914 the Clayton Anti-trust Act was passed. This act amended and reinforced the Sherman Act. The Sherman Act provided for criminal prosecution by the government, injunctions by the government, or damage suits by individuals for violation of the Act. The Clayton Act permitted the use of an injunction by an individual. The basic idea of the Clayton Act was to clear up inconsistencies in the Sherman Act, but due to the ambiguity of the language used in it, there was little improvement afforded.

These two acts are the basic legislation existing in regard to Anti-trust law, remaining on the statute books without modification until the 1930's. In 1938 the Robinson-Patman Act was passed in the field of Anti-trust law, but this did not affect the two basic acts materially. It was, in effect, a modification of the Clayton Act and was concerned with prohibition of price discrimination. The government prosecutors attacked organizations that were engaged in monopoly or conspiracy in restraint of trade by applying the rule of law spelled out in the two basic acts as amended by the Robinson-Patman Act.

In 1940-1946 both of these acts were used as the basis of the Lexington, Kentucky Case in which companies engaged in tobacco manufacture were prosecuted for monopoly and conspiracy in restraint of trade.

These two Acts are guide posts for the industry and the courts use of them resulted in a complete reorganization of the industry in 1911, and the prohibition of specific actions and activities in 1946. It falls upon the tobacco industry to take cognizance of these two acts and so conduct itself in business activities and policies so as to stay within the legal framework of the law.

The American Tobacco Company was incorporated at approximately the same time as the passage of the Sherman Anti-trust Act, and in 1911 the United States Supreme Court ruled against American policy, applying this act and bringing about a dissolution of the "Trust". James Duke, president of the American Tobacco Company, was well aware of existing Anti-trust legislation and had made a concerted effort to keep the "Trust" free from indictment and prosecution.

Initially American had planned to incorporate in the State of Virginia, but the legislature acted to discourage monopoly formations. In May 1890 the State of North Carolina passed an anti-trust act and actions under the act was brought against the Duke firm; however, this action was dropped and American had a brief respite.

From 1893 to 1899 action was brought against American in each of four states for anti-trust violations, the states being New Jersey, Illinois, New York, and Missouri, however, in each instance the state involved ran into legal difficulty and there was no penalty levied on the American Tobacco Company.

In 1907 the American Tobacco Company was indicted for monopoly and restraint of trade under the Federal law - The Sherman Anti-trust Act. In the district court, the Court of Appeals, and the Supreme Court of the United States the decisions were adverse to the "Trust" and resulted in the dissolution of American.(3)

Following the decision, Duke and his associates worked out a plan of dissolution with the guidance of Attorney General Wickersham, and on November 16, 1911 the plan was approved by the court and issued as a formal decree.

The subsidiary companies were severed from the "Trust" and American Tobacco was divided thus; American retained assets of $98.4 million including $53.4 million of tangible assets;

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(3) Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven, Connecticut 1950) p. 59

Liggett and Myers was reorganized and received $67.4 million in assets including $28.1 million in tangible assets; R. J. Reynolds also received a proportionate share of the former trust.

Three years were allowed by the court for the dissolution to take place, and Liggett and Myers and Lorillard securities were left to the hands of a trustee to remove American's control over them.

The effect of the court decree was to reduce the assets and business of the American Tobacco Company to a fraction of its former size and establish an oligopolistic industry structure.[4]

Major controversy developed regarding dissolution, a principal critic being Justice Harlan, who partly concurred with the findings and partly dissented. Assistant Attorney General McReynolds, who had prosecuted the case for the government considered the settlement, "a subterfuge fit only for the scrap heap."[5]

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(4) Ibid., pp. 60-63.

(5) Ibid., pp. 68.

TABLE 5

PERCENTAGE DIVISION OF THE NATIONAL TOBACCO BUSINESS UNDER THE DISSOLUTION DECREE, BASED ON THE 1910 OUTPUT OF EACH PLANT

	American	Liggett	Reynolds	Lorillard	Other
By Quantity					
Cigarettes	37.1	27.8	----	15.3	19.8
Smoking	33.1	20.1	2.7	22.8	21.4
Plug	25.3	33.8	18.1	3.7	19.0
Fine Cut	9.9	41.6	----	27.8	20.6
Cigars	6.1	----	----	5.7	86.6
Little Cigars	15.4	43.8	----	22.8	7.0
Snuff	----	----	----	----	100.0
By Value					
Cigarettes	33.2	21.0	----	26.0	19.8

SOURCE: Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven Connecticut 1950) p. 61.

TABLE 6

OUTSTANDING SECURITIES OF THE AMERICAN TOBACCO COMPANY, 1911 AND 1915

	MILLIONS OF DOLLARS	
Issue	November 16, 1911	December 31, 1915
6% Bonds	$ 52.9	$ .8
4% Bonds	51.4	1.4
6% cumulative preferred stock	78.7	52.7
Common Stock	40.2	40.2
	$223.2	$95.1

SOURCE: Tennant, Richard B., The American Cigarette Industry, (Yale University Press, New Haven Connecticut 1950) p. 62.

Critics of the dissolution objected to monopolies given companies for the production of specific cigarette brands and to the large size of the successor companies.

The United States Supreme Court, in a later hearing, refused to enforce further disintegration of the combination. Attorney General Wickersham thought that the oligopolistic structure which had evolved was much better than a division of the industry beyond the point of economic feasibility.

This decision by the United States Supreme Court was an issue of the presidential election of 1912, and subsequent to his election President Woodrow Wilson appointed the prosecutor McReynolds to the cabinet position of Attorney General.

CHAPTER IV

Price, Advertising, and Products Differentiation After 1900

After 1900 the newly formed companies of R. J. Reynolds, American Tobacco Company and Liggett and Myers concentrated on the production and sale of the three most popular brands, Camels, Lucky Strike and Chesterfield. There was no precise pattern of price behavior among these brands until 1917 when the rising success of Camels was instrumental in setting the price range for Chesterfield and Lucky Strikes.

From 1912 to 1923 these three companies alternated in the establishment of an effective price with Reynolds initiating three price changes; one increase and two decreases, which were adopted by the rival companies very quickly. American unsuccessfully initiated one price increase and succeeded in initiating one price decrease; Liggett and Myers initiated one price increase; however, Reynolds exercised dominance as regards price changes in the overall analysis and became the price leader for the period 1917-1923.[1]

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(1) Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbilt University Press, Nashville, Tennessee 1951) p. 56.

During the period between 1923-1931 cigarette price policies were subordinate to the other two oligopolistic characteristics, advertising and selling policies. Price changes were few and were a result of a shift in market position of the three companies rather than a general price war, and the price policies of American, Reynolds, Liggett and Myers and Lorillard crystallized into a clear-cut oligopolistic pattern characterized by non-aggressive price behavior.(2)

There were only three price changes during this period in the major brands of cigarettes, one reduction and two increases. In each instance the price leader was Reynolds, and Lucky Strike and Chesterfield soon followed Reynolds or Camels lead. With but few exceptions list prices of the four major companies were identical.(3)

The R. J. Reynolds Tobacco Company and its product Camels dominated sales and price policies from 1900 to 1931 but in the years 1923-1931 Lucky Strike displaced Camels as the nation's leading cigarette.

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(2) Ibid., p. 78.

(3) Ibid., p. 88.

Even though American Tobacco Company's, Lucky Strike captured the lead in production and sales, R. J. Reynolds with Camels, maintained the position of price leader in the market and Liggett and Myers with Chesterfields was content to occupy the third position as far as production and sales following the trend established by the other two companies.[4]

During the period between 1931 and 1939, the major companies experienced keen competition by independent manufacturers as the price increase of 1931 to $6.85 per thousand created a margin for attractice profit, which led to additional entry into the tobacco industry.

In 1933 the American Tobacco Company led with two successive price cuts, from $6.85 to $6.00 on January 2, 1933, on February 10 they cut the price of cigarettes from $6.00 to $5.50 per thousand. Their lead was followed by all of the principal companies.[5]

These price cuts succeeded somewhat in reducing the advantage and disrupting the operation of the independent companies,

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(4) <u>Ibid</u>., p. 111.

(5) <u>Ibid</u>., pp. 114-117.

and in 1934 R. J. Reynolds and Camels adopted a more moderate price policy, raising Camels from $5.50 to $6.10 per thousand. American followed the price raise immediately, and Liggett and Myers, which had thought $5.50 was too low, was glad to follow.[6]

During one-third of the period 1939-1950 cigarette price policy was entirely subject to forces outside of the industry, as the Office of Price Administration began functioning in January 1942 and maintained operations through June 1946. During these war years there was an unlimited demand for cigarettes, and the supply was determined by maximum production schedules; however, the rate of profit on production was quite curtailed by government price control.[7]

During the period of 1939-1950 the price policies of the tobacco leaders, American, Lorillard, Liggett and Myers and Reynolds was one of circular interdependence as the raising of prices by one would lead to price rises by the others and the same held true for price reduction. After careful analysis by Mr. Nicholls, it has been determined that R. J. Reynolds Company and Camels was the market leader for price rises and that American Tobacco Company was the market leader for price declines.

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(6) Ibid., pp. 121 and 122.

(7) Ibid., p. 151.

The general theory of oligopoly prices is that the several firms that have control of the market seek, without tacit agreement, to maximize profits. They produce their products to the point where marginal costs equal marginal revenue.[8]

The major companies raised their prices in 1931 to such a high level that they attracted considerable competition from independent competitors; therefore, the companies adopted two price cuts in 1933, and in 1934 they established more moderate price levels, resulting in a fair price but one that did not give undue advantage to the independent competitors.

Summing up price policy, it appears that Reynolds led in upward adjustments, American led in downward adjustments, and Liggett and Myers and Lorillard were in most instances willing price followers.

Prices played an important role from 1900 to 1931 in determining market leadership; however, from 1923 to 1931 the cigarette industry was relatively stabilized. There was rivalry after the dissolution of the "Trust" but it was limited to the

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(8) Chamberlin, Edward Hastings, <u>The Theory of Monopolistic Competition</u>, (Harvard University Press, Cambridge, Massachusetts 1960), p. 75.

four successor companies of Reynolds, American, Lorillard and Liggett and Myers as these four companies dominated the industry. In their struggle, the major weapon which was utilized was that of advertising, but prices were also very important.

In 1925 Mr. George Washington Hill succeeded to the presidency of the American Tobacco Company and he utilized many of the tactics and ideas that were originated by James B. Duke. He took over personal control of the advertising program and related policies which he controlled carefully. One innovation that he used was the caption "Reach for a Lucky Instead of a Sweet"[9] in an intensive bid to capture the patronage and demand of the woman smoker. He emphasized the idea of the slim, beautiful woman and inferred that the smoking of Lucky Strikes would help to achieve beauty.

His program was quite bold in comparison with the Chesterfield slogan used by Liggett and Myers which was, "Blow some My Way" as a caption under the picture of a pretty girl. Hill was subject to a great deal of criticism from churches, rivals, candy manufacturers and others, but his answers were that the results were quite excellent. He demanded and received from his sales force the same spirit and zeal that he evidenced.

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(9) Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbilt University Press, Nashville, Tennessee 1951) p. 58.

TABLE 7

SUMMARY OF PRICE LEADERSHIP AMONG THE THREE MAJOR COMPANIES MANUFACTURING CIGARETTES 1917-1950

Time Period	Company	Successful Leads			Unsuccessful Leads		
		Up	Down	Total	Up	Down	Total
1917-23	Reynolds	2	2	4	0	0	0
	American	0	1	1	1	0	1
	Liggett & Myers	1	0	1	0	0	0
	Uncertain	2	0	2	0	0	0
1924-39	Reynolds	4	1	5	0	0	0
	American	0	2	2	0	0	0
	Liggett & Myers	0	0	0	0	0	0
1940-50 (ex OPA)	Reynolds	2	0	2	0	0	0
	American	2	0	2	1	0	1
	Liggett & Myers	0	0	0	2	0	2
1917-1950 (ex OPA)	Reynolds	8	3	11	0	0	0
	American	2	3	5	2	0	2
	Liggett & Myers	1	0	1	2	0	2
	Uncertain	2	0	2	0	0	0

SOURCE: Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbuilt University Press, Nashville, Tennessee, 1951) p. 175.

President James Gray of the Reynolds Tobacco Company stated that he believed in a conservative advertising policy in which the quality of the product speaks for itself. As to his advertising copy, this was prepared by an agency, which assumed the responsibility for advertising success. Gray did not require uniformity of policy among his salesmen and he varied the outlay for advertising expenses from year to year according to the need.

In advertising Chesterfields, Liggett and Myers appealed to simplicity and taste. Its advertising has been as extensive as that of rivals, it was more conservative, did not criticize rivals and avoided reference to medical benefits. There was an emphasis of the uniform quality and the satisfying character of its blend.[10]

Advertising has a direct effect on demand with increases in proportion to the monetary outlay. The demand for cigarettes has been found by economists to be relatively inelastic and any elasticity at all depends upon an increase in population resulting in an increase in consumption or an increase in the national income or gross national product.

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(10) Ibid., pp. 59 and 60.

Mr. Hill stated regarding advertising, "Of course, you benefit yourself more than the other fellow . . . . . , but you help the whole industry if you do a good job."[11]

Liggett and Myers objective in promoting Chesterfields was to serve and satisfy its old customers and make new ones and Reynolds used advertising to hold the overall consumption of Camel cigarettes at as high a rate as possible.

Independent cigarette companies provided important competition to the major producers. First, the price increase of 1931 by the big three brought into the market a number of independent brands principally, Philip Morris. Second, the price wars of the 1930's had practically wiped out the distributor's margin and dealers were receptive to brands offering a price differential. Third, the price of the major brands dropped from 15 cents per pack to 11-13 cents per pack and the independent brands were able to capture the prestige carried by the big three of the industry without exceeding what had come to be considered the customary price for cigarettes.

Philip Morris was able to sell its cigarettes for $6.35 per 1,000 cigarettes in tax free states and still maintain a

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(11) Ibid., p. 60.

TABLE 8

TOTAL ADVERTISING OUTLAY BY THREE PRINCIPAL

TOBACCO COMPANIES 1925-1931

Year	Reynolds	American	Liggett & Myers
	(000)	(000)	(000)
1925	$10,100	$ 8,785	----*
1926	17,640	7,782	----*
1927	19,473	12,180	----*
1928	12,872	12,191	----*
1929	9,934	13,711	----*
1930	15,138	19,718	$12,000
1931	16,057	23,680	----*

* Data for these years not available.

SOURCE: Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbilt University Press, Nashville, Tennessee 1951) p. 61.

price of 15 cents per pack. This price was 2 to 4 cents above Chesterfield, Camels, and Lucky Strike, and between 1933 and 1939 with this advantageous price policy they increased gross sales from 6 to 11.1 billion.[12]

After 1931 there was a sharp reduction in advertising outlays by the major tobacco companies and these conservative advertising policies were of great benefit to Lorillard's and Philip Morris, as they were able to advertise their product on an equal basis.

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(12) Ibid., pp. 127-129.

TABLE 9

TRACEABLE TOTAL AND UNIT ADVERTISING COSTS OF THE THREE

MAJOR CIGARETTE BRANDS, 1931 TO 1939

Year	Advertising Costs (000) Magazines, Newspapers, Chain Radio Time			Possible Range in Advertising Costs Per 1,000 Cigarettes		
	Camels	Lucky Strike	Chesterfield	Camels	Lucky Strike	Chesterfield
1931	$10,006	$13,649	$ 9,130	.300 - .482	.307 - .532	.438 - *
1932	2,389	10,850	11,138	.100 - .227	.296 - .677	.523 -
1933	10,248	7,192	7,590	.400 - .582	.196 - .298	.259 -
1934	10,572	8,120	9,575	.318 - .523	.253 - .393	.300 -
1935	9,384	5,577	9,443	.238 - .367	.182 - .342	.297 - .523
1936	9,276	6,837	8,908	.200 - .321	.210 - .533	.259 - .455
1937	8,428	6,879	9,332	.176 - .313	.170 - .296	.269 - .489
1938	8,648	5,665	8,661	.198 - .355	.156 - .270	.257 - .501
1939	7,875	4,296	7,713	.184 - .359	.112 - .252	.233 - .476

*Chesterfield data partially incomplete.

SOURCE: Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbilt University Press, Nashville, Tennessee, 1951) p. 131.

CHAPTER V

The Social Control of Oligopoly and The Lexington, Kentucky Case of 1940-1946

The Tobacco Case of 1940-1946 was significant, not only as an important application of the Sherman and Clayton Anti-trust Acts to a specific set of circumstances, but also as to the establishment of precedents in the interpretation and application of these acts. This case was a criminal case with a jury trial and many questions have been raised as to its effectiveness and appropriateness.[1]

The Tobacco Case was initiated on July 24, 1940 in Lexington, Kentucky. It charged eight major tobacco manufacturers and leaf dealers with violations of Anti-trust legislation, principally Section 1 and 2 of the Sherman Act as to: conspiracy in restraint of trade, monopoly, attempts to monopolize and conspiracy to monopolize. It was alleged that these violations were committed by obtaining control of the leaf sale system and exercising such power as to deprive the average tobacco grower of bargaining power; formulation of tobacco

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(1) Nicholls, William H., Price Policies in the Cigarette Industry, (Vanderbilt University Press, Nashville, Tennessee 1951), p. 337.

grades and manipulating leaf prices to avoid competition and to restrain outside competition from independent companies; establishing factory prices for their product to eliminate price competition among themselves and maintaining a system of artificial control over prices; domination of distributors as to practice and policy which would provide personal benefits; tacit agreement as to wholesale and retail prices.[2]

The leaf sale system established the grading and sorting of leaf tobacco in approximately one hundred pound lots. These lots are placed in baskets on the warehouse floor and auctioned off to the highest bidder on regularly scheduled sale dates.

On September 9 the defendents filed motions to quash. In addition they filed demurrers to specific charges and both actions were overruled by the court on October 31; then the defendants entered pleas of not guilty and requested that the Federal Government present a bill of particulars alleging the facts with which they were being charged.

American Tobacco Company, R. J. Reynolds and Liggett and Myers were required to produce a great number of records and documents, as to their business affairs, which were given detailed examination by the court. On June 2, 1941 the trial began and the above mentioned companies stood trial. The other defendants

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(2) Ibid., pp. 338 and 339.

entered pleas of "nole contendere" and did not stand trial but were subject to fines in the event that the principal three companies were convicted.[3]

The trial was conducted at Lexington, Kentucky in the heart of the burley tobacco growing region. It was quite difficult to empanel a jury not connected with the tobacco industry and in the selection procedure over forty jurors were dismissed for cause. Of the fourteen jurors selected, two alternates being included, none were tobacco growers and they were all from small towns but one, and most of them had close relatives engaged in the tobacco business. The trial itself lasted from June 2, to October 27, 1941 and included over 10,000 pages of testimony. There was great oratory, showmanship and clever legal moves and countermoves which added to the confusion and clouded the issues. The results of this trial pointed out weaknesses of jury trials when applied to the activities of large industry.[4]

The criminal proceedings were less restrictive in one important regard however, for in the application of the rules of evidence the Government was aided greatly by a liberal application of these rules on the part of the court. For this

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(3) Ibid., pp. 340 and 341.

(4) Ibid., pp. 342 and 343.

reason, the defendants entered assignment of error in over one hundred instances. Despite the liberality of the Judge, the Federal Court of Appeals found only seven objections to which it gave examination and it was decided that none of these objections had merit.[5]

The prosecution in summing up its case against the defendants stated that Section 1 and 2 of the Sherman Act had been clearly violated and evidence of a signed contract, exchange of letters, or joint conferences was not necessary. If there was a "WORKING AGREEMENT" or common plan to control the price of leaf tobacco or the market price of the final product, the defendants were guilty. As to monopoly, the Government alleged and proved by circumstantial evidence that there was a flagrant abuse of power.[6]

Defendants were alleged to have maintained an oligopoly control over the leaf market by several means. Unless the buyers from all three of the major companies were present there would be no major buyer. Dates for buying from each specific market were set through an organization known as the Tobacco Association of the United States without regard to the interest or convenience of the individual farmer. Finally, the rules and procedures for marketing were set by local boards of trade

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(5) Ibid., p. 344.

(6) Ibid., p. 345.

dominated by the defendants. The defendants purchased two-thirds of the Burley Tobacco and 80 to 85 percent of the Bright or flue cured tobacco and the Government pointed out that due to the perishability of his crop the average farmer had little or no bargaining power when dealing with the buyers of defendant's firms.(7)

Percentage buying was also practiced by defendants wherein each was aware of the demand of his competitors and bought accordingly, in addition each defendant bid on a different grade of tobacco thus restricting if not eliminating competition.(8)

Percentage buying is a system used by the tobacco companies for determining the amount of tobacco to be purchased in each market. The total crop to be marketed is estimated in pounds and then the poundage or percentage of buying in each market is determined. As the selling season progresses adjustments are calculated for individual markets so that the buyers can get the required volume of tobacco.

Another charge made by the Government prosecutor as regards the defendants was control of list prices. American Tobacco Company, R. J. Reynolds and Liggett and Myers had concentrated production on their leading brands and had maintained identical prices

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(7) Ibid., p. 346.

(8) Ibid., p. 347

on Lucky Strike, Camels, and Chesterfields sold to the consumer. They presented a united front to distributors who received identical discounts from each and therefore, had no incentive for promoting one brand over another. The defendants had a direct list of wholesalers and retailers to whom they made bulk sales, and if these dealers altered prices they were threatened with being dropped from the accepted list.

This list price identity was a matter of combination and conspiracy among the defendants as there was no relationship between leaf costs and cigarette list prices, and the defendants charged the list prices at the same time, there being a price leader with all the remaining companies following immediately. The Government specifically referred to the 1931 price increases and the 1933 price cuts, which were simultaneous for all the defendants, in making its charge of monopoly and conspiracy.[9]

The Government in its final summation alleged that the working arrangement between the defendants was so perfect that they considered themselves prosecution proof. Having agreed to price identity as regarded both leaf purchase and market price of product and in addition a three cent differential between standard and economy brands, the market would operate without the necessity of formal contracts or frequent meetings. Although there

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(9) Ibid., pp. 347 and 348.

was fierce competition among the big three as regards advertising and sales promotion, they could avoid price competition and thus have a bigger resultant profit to share and this the Government alleged was a fundamental violation of the Sherman Act.[10]

The defendants main argument in the defense of their case was that there was no specific proof of conspiracy and monopoly and that the prosecution was too liberal in its interpretation of the Sherman Act. The defendants admitted that there was a similarity of practices, prices, and products but stated there was a complete absence of agreement or understanding between each other and the resultant condition was the result of an oligopolistic industry and imperfect competition.

The defendants argued that they could not be held accountable for the high cost of entry due to inventory requirements, federal stamp taxes and the necessity of a large advertising outlay. They pointed out that since 1931 both Philip Morris and Raleigh had started operations and had become quite successful. There was no evidence of merger or no unlawful combination by any of the companies and the defense argued that there was insufficient and circumstantial evidence and that they should be found not guilty.

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(10) Ibid., p. 349.

As to the leaf marketing system, they stated that they had no direct control over the system and that they required buyers from each of the big three to be present in the same market so as not to be guilty of buying too cheaply or to be charged with dividing the markets. They also explained the theory of percentage buying of leaf and explained its flexible nature and justified the company grading system as the means of acquiring the type and grades of tobacco needed in processing and manufacturing a final uniform product.(11)

As to concentration of one brand of cigarettes, the defendants stated that this was a necessary consequence of their advertising policies and was required to achieve economy. The defendants argued that list price identity was a result of natural competitive law and was the basis of American enterprise.

Defendants argued that the basic idea of follow the leader was not illegal as each company, without formal or informal agreement with others, has a right to determine the ultimate price of its product. The mere fact that the list price of each of the big three's product was the same was a result of an oligopolistic market.

In his charge to the jury Judge Ford stated the specific indictments or counts were four in number and instructed the jury

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(11) Ibid., pp. 350 and 351.

as to monopoly and conspiracy specifying that mere communication between the defendants which resulted in conspiracy and monopoly, was sufficient to bring them within the provisions of the Act.

Judge Ford summarized the evidence in five general categories:(12)

(1) Historical - the growth and development of the industry for over a half a century, including the organization and dissolution of the Tobacco Trust and the relationship of the defendant companies to the trust;

(2) Opportunity and Motive - membership of the defendants in the Tobacco Merchants Association and the bonus plan for the executives of the defendant companies;

(3) Power - the size and earning power of the defendant companies;

(4) Marketing Systems and Conditions - markets, boards of trade, the Tobacco Association of the United States, leaf buying practices;

(5) Identity of Action and Policy - list prices, customer lists, the granting and withholding of favors to distributors, activities dealing with retailers, advertising;

The Denver Incident was also included and Reynolds was required to produce its records. This was an examination of the

(12) Ibid., p. 355.

differences in price policies between the major producers and the independent manufacturers.

Judge Ford next instructed the jury as to the finding of conspiracy and monopoly stating that if they found such did not exist they need go no further. If the finding was in the affirmative, questions of intent and accomplishment must be answered. As to the defendants, they were being tried as corporations and were guilty if the corporations had knowledge of conspiracy in restraint of trade or engaged in monopoly practice.[13]

The jury deliberated for 15½ hours during the course of two days and after receiving additional instruction returned a verdict of guilty, on October 27, 1941, to each of the four counts and for each of the three defendants. On December 11, the court overruled motions to set aside the jury verdict and grant a new trial and fined each of the three defendants companies $15,000, assessing all of the other defendants as well for a total fine of $255,000.

Three years later December 8, 1944 the Circuit Court of Appeals affirmed the conviction and on petition of certiorari the case was carried to the United States Supreme Court where the judgement of the lower court was affirmed on June 10, 1946.[14]

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(13) Ibid., p. 355.

(14) Ibid., pp. 356 and 357

In the Tobacco Case the court applied the "rule of reason", and although it was not able to apply the traditional tests of the Sherman Act as to conspiracy where actual agreement must be shown, and as to monopoly where overt predatory action to exclude competition must be shown, they effectively broke new ground in their interpretation and ruling. They accepted evidence of detailed similarity of behavior among competitors, which although circumstantial, was used to establish the charge of conspiracy. As to monopoly, the test was the existence of power to exclude competition, not the abuse of such power.(15)

In their appeal to the District Court of Appeals and finally to the United States Supreme Court the defendants, principally R. J. Reynolds and Liggett and Myers, presented the idea of circumstantial evidence and its inherent weaknesses as their main appeal. They had stated before the lower court that the Government had presented no formal documents or certain evidence in the charge of conspiracy.

The prosecution had extended the doctrine of the Interstate Circuit Case in which a formal agreement in writing showing evidence of concerted action was introduced in evidence and had proceeded on a course which would include evidence of a similar course

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(15) Ibid., p. 358.

of conduct. The defendants objected strenuously to the court's interpretation, but the District Court of Appeals reviewed the evidence somewhat in the same manner as it had been summarized to the jury by Judge Ford, and held that the evidence was sufficient to come within the provisions of the Sherman Act, taking a broad interpretation of the Act.

The Supreme Court decision was limited to the question as to whether actual exclusion of competition is necessary to the crime of monopolization. This basic question had never been previously considered by the court. The court was to decide if there is a difference between overt action to establish a monopoly and monopoly thrust upon the parties involuntarily. The Supreme Court, in a unanimous opinion written by Justice Burton, held that a course of action which results in a monopoly is covered by the Sherman Act just as where there is a deliberate attempt to exclude competition.

The major tobacco companies were uncertain in proceeding on an industry wide basis without violating the law as it had been interpreted by the courts.

With the development of the theory of monopolistic competition or imperfect competition after 1930 a wide gap was opened up between the economists view of monopoly and the legal interpretation, the law emphasizing the idea of restriction of competition and the economists emphasizing the idea of the individual firm's control over prices.(16)

Although the governmental victory in the Tobacco Case was complete, there arises a question as to the consequences of this victory. To be certain the Sherman Act has been extended in scope and new ground had been broken in the field of Anti-Trust law; however, Mr. Nicholls stated that the end result is a matter of conjecture. Having achieved victory, the Federal Government had been rather indecisive in its follow up program.

Since the courts and the prosecution provided no clear answer as to how an oligopoly was supposed to function, the major tobacco companies have followed the same price policies as before the trial, and buyers of the major firms are all present at the market place, buying on instructions from headquarters and gauging their purchases on a percentage basis. Tobacco prices to the ultimate consumer are somewhat lower; however, if there has been any change at all as regards the oligopolistic structure of the market, it has been a move towards greater concentration of economic power.

The question presents itself as to the social control of oligopoly directly connected with the Tobacco industry. Granted,

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(16) Ibid., p. 394.

the government had achieved a major victory in the field of anti-trust legislation, but what of the future and of the social consequences involved?

In 1911 the "Tobacco Trust" was dissolved, and at the time Attorney General Wickersham expressed the opinion that the plan of James B. Duke and his associates was quite acceptable and, that due to the nature of the tobacco industry with a need for large and expensive inventories, that the resulting oligopolistic structure was satisfactory. The general consensus of opinion of economic experts was that it would not be economically feasible to require further division of the industry. The tobacco industry in general and the cigarette industry in particular exist today in much the same structure as that devised at the time of dissolution of the "Trust". The majority of business is done by the American Tobacco Company, R. J. Reynolds, and Liggett and Myers. In addition, there are a number of independent firms that are financially successful but they occupy only a small percentage control of the general market.

It has been recommended that the government might use social control of advertising by establishing a tax to be levied upon advertising outlay. This tax would be based on a graduated scale which would discourage large advertising outlays and equalize the market demand condition between the large firms and the independents.

Some examination of this recommendation has been made in various economic studies by Nicholls, but there has been no positive action in this direction by the Congress. One objection to this idea is that it would be a departure from the "Laissez Faire" attitude characterizing the relationship between government and big business in which general operating policies have not been too greatly interferred with in the past.

Another recommendation is in regards to the cigarette tax levies wherein two basic ideas have been proposed; first, that the cigarette tax be abolished; second, that taxes continue with the substitution of graduated or straight ad valorem taxes for the present flat rates.

As to the first proposal, it is not acceptable to the government because the cigarette tax is the source of large amounts of revenue which the government could ill afford to lose. Likewise a graduated cigarette tax, which might help in the regulation of the oligopoly, has not received favorable support in the Congress of the United States.

The Tobacco Case is a legal milestone in the control of oligopoly; however, whether the Government victory will be a millstone or a milestone will depend upon further interpretation and application of Anti-Trust Law. The law and the economists must combine their best efforts in meeting the challenge that the Tobacco decision has so forcefully laid down.(17)

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(17) Ibid., p. 423.

CHAPTER VI

An Analysis of the Current Position of the Major Tobacco Companies For the Year of 1961

Pertinent balance sheet data and income data are presented for the American Tobacco Company, Consolidated Cigar Corporation, Liggett and Myers Tobacco Company, Philip Morris Inc., R. J. Reynolds Tobacco Company and the United States Tobacco Company showing a growth pattern for more than ten years of operation.

A ratio analysis for current operations has been prepared so that an up to date appraisal can be had for the financial position of each company and a picture of future development in the industry can be seen.

Without this analysis vital details necessary to the proper understanding of the oligopolistic structure of the industry and its future growth and development within the framework of anti-trust legislation would be missing; therefore this factual information along with concluding statements is presented to bring the industry into sharp focus with respect to representative companies and their current operating status.

RATIO ANALYSIS

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

The purpose of this ratio is a test for liquidity and for comparison, the absolute standard is 2 to 1.

$$\text{Acid Test Ratio} = \frac{\text{Current Assets - Inventory}}{\text{Current Liabilities}}$$

The purpose of this ratio is for an inventory check and for comparison, the absolute standard is 1 to 1. If the current ratio is adequate and the acid test ratio drops below 1 to 1 this indicates too large an inventory.

$$\text{Quick Ratio} = \frac{\text{Cash + Near Cash}}{\text{Current Liabilities}}$$

The purpose of this ratio is to check for liquidity of position and for comparison, the absolute standard between .5 to 1 and 1 to 1.

$$\text{Receivable Turnover} = \frac{\text{Credit Sales per year}}{360} = \text{credit sales per day}$$

$$\frac{\text{Total Receivables}}{\text{Credit sales per day}} = \text{Age of receivables}$$

The purpose of this ratio is to check the credit standing of your customers and 40 days or below is the absolute standard of comparison.

$$\text{Productivity Ratio} = \frac{\text{Net Income}}{\text{Total Assets}}$$

The purpose of this ratio is to compare the per cent of earnings to total assets to indicate a company's earning capacity.

$$\text{Financial Ratio} = \frac{\text{Net Income}}{\text{Net Worth}}$$

This indicates the rate of return of earnings on the investments of the stockholders and is a guide in determining the prospective future of a company financially.

THE AMERICAN TOBACCO COMPANY

This company accounts for over 25 per cent of total U.S. cigarette sales and although the sale of Lucky Strikes has slipped in recent years the progress for Tareyton and Pall Mall has been most encouraging for sales rose a total of 6 per cent for the seventh consecutive year of growth. Higher sales and further operating efficiency caused an increase in operating income of 7.9 per cent and income before taxes increased 9 per cent and net income showed an increase of 10 per cent for 1961.

Prospects for 1962 are bright and demand for Pall Mall and Dual Filter Tareytons is strong and despite the likelihood of higher advertising outlays, the larger volume of sales and continued emphasis as to operating efficiency and net income should be maintained or slightly increased, as is stated in the Standard and Poor's report. The company believes that the latest medical attack on cigarette smoking will not have a permanent adverse effect on its sales and earnings; however it has had an effect on the market price of common and preferred stock. A new brand of cigarettes is being introduced in 1962, Montclair, with a flavored filter and it is being test marketed in Memphis and Indianapolis.

Stock	Approx. Price	Dividend	Yield
Common (wi)	41 7/8	$1.50	3.6%
$6 Preferred	132	$6.00	4.5%

TABLE 10

INCOME STATISTICS AND EARNINGS

(millions)

Year Ended Dec. 31	Total Sales	Net Sales	Operating Expense	Depreciation	Net Income	Preferred Earnings	Common Earns	Common Dividends Paid
1961	$1,288.4	781.9	20.5	5.7	68.73	130.22	2.52	1.40
1960	1,215.3	724.1	20.5	5.5	62.52	118.45	2.28	1.36¼
1959	1,161.4	681.3	21.6	5.2	63.25	119.25	2.31	1.25
1958	1,105.2	639.4	21.7	4.8	58.86	111.51	2.14	1.25
1957	1,098.1	621.4	21.3	4.2	57.09	108.17	2.07	1.25
1956	1,091.2	593.8	20.9	3.8	51.69	97.93	1.86	1.25
1955	1,090.8	585.9	21.4	3.5	51.66	97.88	1.86	1.10
1954	1,068.6	568.4	18.5	3.4	43.05	81.56	1.52	1.10
1953	1,088.4	574.5	20.3	3.2	43.23	78.23	1.48	1.10
1952	1,065.7	545.3	16.7	3.1	34.07	64.65	1.19	1.10
1939	262.4	152.0	23.1	1.4	26.43	50.15	1.28	1.25
1938	253.1	131.2	23.9	1.3	25.44	43.27	1.23	1.25
1937	242.6	126.2	----	1.9	26.20	49.71	1.26	1.25

SOURCE: American Tobacco Company, Standard Listed Stock Reports, Standard and Poor's Corporation, April 1962, p. 184.

TABLE 11

PERTINENT BALANCE SHEET STATISTICS

(millions)

Dec. 31	Gross Prop.	Capital Expend.	Cash	Inventory	Receivables	Current Assets	Current Liabs.	Long Term Debt
1961	131.44	6.47	18.3	747.2	62.5	827.9	237.9	99.88
1960	127.45	7.84	20.4	693.4	56.6	771.8	175.8	175.74
1959	123.62	9.12	17.7	656.7	53.6	728.0	140.4	150.65
1958	117.66	10.95	20.7	648.3	48.3	717.3	143.2	165.40
1957	106.65	10.83	27.0	671.4	46.1	740.5	171.1	179.33
1956	97.72	6.36	23.4	655.1	45.9	724.4	152.8	193.19
1955	89.20	6.15	23.6	656.2	47.8	727.6	171.8	206.33
1954	84.99	4.41	26.4	632.1	44.5	703.1	152.6	218.97
1953	82.08	5.51	29.5	651.0	45.1	725.6	177.3	231.27
1952	77.34	3.76	26.4	640.8	45.5	712.7	161.4	243.57

SOURCE: American Tobacco Company, Standard Listed Stock Reports, Standard and Poor's Corporation, April 1962, p. 184.

RATIOS OF AMERICAN TOBACCO COMPANY

Year	Current Ratio	Acid Test Ratio	Quick Ratio	Receivables Turnover	Productivity Ratio	Financial Ratio
1961	3.5 to 1	.33 to 1	.08 to 1	17 days	.07 to 1	-----
1957	4.3 to 1	.40 to 1	.15 to 1	12 days	.07 to 1	-----
1952	4.4 to 1	.44 to 1	.16 to 1	15 days	.04 to 1	-----

The current ratio position is excellent as the absolute standard is 2:1 and the acid test ratio is acceptable considering the nature of the industry and the need for excessive inventories; however the quick ratio indicates a critical cash position and indicates the necessity of financing to meet operating expenses. The receivables turnover indicates an active and successful credit department as 40 days is permissable as a standard. The productivity ratio indicates earnings to total assets which reflects a good indication of a successful operation.

The American Tobacco Company is financially sound and prospects for future growth and continued expansions are good. It justifies its position of an industry leader in this analysis.

The ratio trend of this company as indicated by calculations at five year intervals indicates no significant trend, and shows a good relative position for each year computed.

CONSOLIDATED CIGAR CORPORATION

Consolidated Cigar is the leading manufacturer of cigars with production and sales in excess of one billion units. Its principal brands are El Producto, Muriel, Havestor, La Palina, Headline, 1886, Lovera and Simon's, retailing from ten cents to three for fifty cents with some volume of twenty five cents cigars. Distribution is through primary wholesale distributors and chain stores. Wrappers and fillers are produced from domestic sources and from Cuba and Puerto Rica.

In 1956 this company purchased the cigar assets of P. Lorillard for $4,600,000 including equipment, machinery, and inventory, and they also acquired several main brands names such as Muriel, Muriel Babies, Headline and Van Bibber. In addition they acquired the holdings of H. Simon and Sons, Ltd. in 1958, a Canadian firm. In April 1961 they took over the operations of Flinchbaugh Products, a machinery company, for 15,625 shares of common stock.

Sales for the nine months period ended September 30, 1961 rose 7.5 per cent over the previous year and net income increased 8.8 per cent. As for future prospects it appears that sales and net income will continue to increase and this company is expected to maintain its share of the growing market substantiated by Standard and Poor's findings.

Stock	Approx. Price	Dividend	Yield
Common (wi)	42 7/8	$1.00	2.3%

TABLE 12

INCOME STATISTICS AND EARNINGS

(millions)

Year Ended Dec. 31	Total Sales	Net Sales	Operating Expense	Operating Income	Maint. & Repairs	Depr.	Net Income	Earnings	Divid. Paid
1961	----	----	----	----	----	----	----	----	.96½
1960	100.14	----	----	10.33	1.28	1.50	4.43	2.01	.86½
1959	90.02	79.5	10.9	8.69	1.26	1.39	4.05	1.82	.78½
1958	82.19	73.1	10.2	7.48	1.27	1.27	3.65	1.69	.66½
1957	76.53	67.8	9.3	6.32	1.01	1.03	3.04	1.41	.34
1956	72.85	64.4	9.7	6.23	.92	2.79	2.79	1.29	.28½
1955	61.77	54.5	8.3	5.05	.76	.51	2.18	1.20	.27
1954	57.83	51.0	7.5	4.27	.51	.39	1.85	.99	.26
1953	54.58	48.2	8.8	4.20	.60	.34	1.59	1.03	.43
1952	52.22	46.0	7.6	3.48	.47	.33	1.48	.96	.43
1951	49.07	43.1	10.2	4.41	.37	.34	2.03	1.32	.43
1950	50.24	43.9	11.2	5.01	.42	.32	2.42	1.57	.43
1939	10.26	9.4	12.4	1.17	.05	.13	.82	.15	.13½
1938	10.11	9.4	14.9	1.19	----	.12	.84	.16	.13½
1937	10.70	9.9	14.7	1.28	----	.12	.89	.17	Nil

SOURCE: Consolidated Cigar, Standard Listed Stock Reports, Standard and Poor's Corporation, February, 1962, p. 608.

TABLE 13

PERTINENT BALANCE SHEET STATISTICS

(millions)

Dec. 31	Gross Prop.	Capital Expend.	Cash	Inventory	Receivables	Current Assets	Current Liab.	Long Term Debt
1960	20.82	4.24	3.48	43.2	10.2	57.48	16.70	17.12
1959	17.54	3.08	3.92	39.7	10.0	54.25	13.18	17.71
1958	15.92	2.92	4.12	36.6	8.4	49.81	10.34	18.40
1957	13.30	2.62	3.56	35.3	7.7	47.12	8.82	19.02
1956	11.07	4.03	3.93	36.4	7.9	48.78	10.60	19.58
1955	7.17	1.84	2.74	32.7	6.2	42.26	9.97	15.00
1954	5.59	.63	2.82	28.1	5.8	37.03	10.47	9.00
1953	5.25	.43	2.62	17.3	5.2	72.51	4.51	9.40
1952	5.09	.51	3.64	16.7	4.7	29.72	4.35	9.80
1951	4.79	.47	1.75	20.8	4.4	32.06	13.13	4.00
1950	5.30	.80	1.42	18.8	4.3	29.31	12.12	4.00

SOURCE: Consolidated Cigar, <u>Standard Listed Stock Reports</u>, Standard and Poor's Corporation, February, 1962, p. 608.

RATIOS OF CONSOLIDATED CIGAR CORPORATION

Year	Current Ratio	Acid Test Ratio	Quick Ratio	Receivables Turnover	Productivity Ratio	Financial Ratio
1960	3.4 to 1	.85 to 1	.20 to 1	36 days	.056 to 1	-----
1955	4.2 to 1	1 to 1	.27 to 1	36 days	.05 to 1	-----
1950	2.4 to 1	.86 to 1	.11 to 1	18 days	.06 to 1	-----

The current ratio position is excellent as it is 1.4 over the absolute standard for 1960 and the acid test ratio indicates that the size of the inventory is within the acceptable boundaries of a tobacco corporation. The quick ratio indicates that there is a good supply of cash and near cash on hand but the position could be stronger. The receivables turnover is approaching the maximum of forty days and it is indicated that a check could be made of the credit department. The productivity ratio shows a fair return on investment and is satisfactory if the fact that there have been large asset aquisitions is taken into consideration.

As far as a trend in ratios is concerned the length of receivables turnover change is significant and indicates a weakness in the credit department.

LIGGETT AND MYERS TOBACCO COMPANY

Net sales of this company declined about 4.9 per cent from the 1960 level of $543,178,587 to a figure of $516,708,042, and the drop was due to a decrease in shipments of Chesterfield Regulars. King Size Chesterfields and L. & M. King Size showed a definite increase.

Net earnings declined from a 1960 level of $28,708,895 to a 1961 level of $26,760,120, and net earnings per share of common stock dropped from $6.96 to $6.47 per share as a result of the decreased sale of Chesterfield Regulars.

1961 marked the fiftieth consecutive year in which dividends were paid on common stock and payments were $1.25 per quarter or $5.00 for the year. A total of $20,917,553 was paid in dividends on common and preferred shares and $5,842,567 was transferred from retained earnings to earned surplus for use in the business.

The financial position of the company was strengthened considerably in 1961 as there was no short term borrowing, long term debt was reduced by $5,750,000 through the use of the sinking fund to retire debentures and net working capital was increased by over $1,500,000. The tax problem continues to be a serious one with federal, state and franchise taxes amounting to a figure of $31,864,000 for income tax and $219,227,047 in federal and other excise taxes.

Capital expenditures amounted to $1,700,000 which was used mainly for machinery and other equipment to improve productive operations efficiency, and the company's overall operation was greatly improved on a cost basis.

Leaf purchases were made at an average price of 63.7¢ per pound, the highest figure on record; however, the overall inventory is carried at average costs and adjusted on a monthly basis, thus making the price per pound considerably below the 1961 average purchase price.

The company has maintained a strong program of research which is instrumental in the maintenance of the highest standards of products quality.

TABLE 14

LIGGETT AND MYERS

CONSOLIDATED BALANCE SHEET

	1961	1960
Current Assets:		
Cash	$ 13,923,707	$ 11,059,994
U. S. Government Securities		4,998,005
Accounts Receivable, Customers	21,708,701	23,223,150
Accounts Receivable, Others	1,152,322	1,151,657
Leaf Tobacco, Avg. Cost	298,454,565	282,169,184
Manuf. Stock & Operating Sup.	32,690,037	32,243,932
Total Current Assets	$367,929,332	$354,845,972
Fixed Assets:		
Land and Buildings	$ 20,722,849	$ 20,578,094
Machinery and Equipment	59,214,150	58,170,734
Total	$ 79,936,150	$ 78,748,828
Less Accumulated Depreciation	46,799,429	43,626,750
Total Fixed Assets	$ 33,137,570	$ 35,122,078
Other Assets:		
Brands, Trademarks, Goodwill	1	1
Investments, Subsidiaries	1,631,396	919,004
Investments, Foreign Companies	4,000	4,000
Foreign Currency Deposits (restricted deposits)	946,731	1,005,034
Prepaid Expenses	1,257,644	1,182,011
Total Other Assets	$ 3,835,772	$ 3,111,950
Total Assets	$404,902,674	$393,080,000

Current Liabilities:		
Accounts Payable	$ 5,340,328	$ 3,167,198
Dividends Payable, Prf. Stock	297,817	311,607
Accrued Interest on Debentures	628,906	675,391
Funded Debt Payable in 1 yr.	5,750,000	5,750,000
Net Taxes Payable (less tax notes)	20,991,916	11,559,209
Total Current Liabilities	$ 33,008,967	$ 21,463,405
Funded Debt:		
2 5/8% Sinking Fund Debentures	72,750,000	78,500,000
Reserve for Contingencies	256,940	248,160
Stockholders Equity:		
Preferred Stock 7% Cum. (Par $100)	16,948,100	17,786,100
Common Stock (Par $25)	98,735,950	98,476,325
Paid in Capital	20,987,493	20,534,676
Retained Earnings	162,215,224	156,071,334
Total Stockholders Equity	$298,886,767	$292,868,435
Total Liabilities and Equity	$404,902,674	$393,080,000

Source: Liggett and Myers Tobacco Company, Annual Report 1961, pp. 14 and 15.

TABLE 15

STATEMENT OF CONSOLIDATED EARNINGS

	1961	1960
Net Sales	$516,708,042	$543,172,587
Other Earnings:		
Interest and Dividends Received	846,920	889,330
Equity in Subsidiary Net Earnings	169,587	-0-
Total Earnings	$517,724,549	$544,061,917
Costs and Expenses:		
Cost of Goods Sold, Selling and Administrative Expenses	452,867,876	474,847,617
Depreciation	3,977,215	3,909,369
Interest and Debt Amortization	2,188,223	2,341,504
Other	67,156	250,532
Federal Income Tax	28,703,000	31,573,000
State Income & Franchise Taxes	3,161,000	2,431,000
Total Costs and Expenses	$490,964,429	$515,353,022
Net Earnings Before Preferred Dividends	$ 26,760,120	$ 28,708,895
Dividends on Preferred Stock	1,205,092	1,301,255
Net Earnings Applicable To Common Stock	$ 25,555,028	$ 27,407,640

Source: Liggett and Myers Tobacco Company, Annual Report 1961, p. 16.

RATIOS OF LIGGETT AND MYERS TOBACCO COMPANY 1960 AND 1961

Year	Current Ratio	Acid Test Ratio	Quick Ratio	Receivables Turnover	Productivity Ratio	Financial Ratio
1960	16 to 1	3.4 to 1	.8 to 1	16 days	.07 to 1	.09 to 1
1961	11 to 1	2 to 1	.41 to 1	16 days	.06 to 1	.09 to 1

The current ratio indicates that the company is in healthy condition with a small current liability which is further substantiated by excellent results in the acid test ratio and quick ratio. The credit department is a credit to the company as the average age of receivables is 24 days below the maximum effective limit and the productivity ratio and financial ratio indicate a smoothly functioning organization.

Recommended action would be to expend additional funds on advertising in an attempt to halt the sliding sales in Chesterfield Regulars and recapture the 1960 volume of sales for the company.

Trend is not indicated as sufficient data was not available for the computations applicable to this company.

PHILIP MORRIS INCORPORATED

Philip Morris is the fifth largest publicly held, domestic cigarette manufacturer, producing over 9 per cent of the industry output and cigarettes account for close to 98 per cent of tobacco revenues. Marlboro, Filter-tip Parliament, Philip Morris Regular and King Size, Alpine, Bensen and Hedges, Spud and the French Gauloises brand are the trade names produced and 92 per cent of the production is for domestic consumption, the other 8 per cent for the export trade.

Philip Morris International exports cigarettes to some 104 countries and territories, subsidiaries and affiliated companies sell to 4 countries and licensees, who make and market company brands and are located in 8 different countries.

Sales in 1961 increased 4 per cent over the 1960 level with growth in Marlboro, Parliament and Philip Morris Commanders. Business of the non-tobacco subsidiaries declined and resultant operating income increased only 2 per cent, with net income sharing again of 2.5 per cent.

A modest increase in production and sales is predicted for 1962 based on increased domestic demand for its three leading brands and foreign sales should increase to cover the cost of some of the broad international expansion taken. Long run gains are predicted for Philip Morris and its subsidiaries.

Stock	Approx. Price	Dividend	Yield
Common	92 ¼	$3.60	3.9%
$4 Preferred	87	$4.00	4.6%
$3.90 Preferred	83 ½	$3.90	4.7%

TABLE 16

INCOME STATISTICS AND EARNINGS

(millions)

Year Ended Dec. 31	Total Sales	Net Sales	Operating Expenses	Depr.	Income	Earnings	Divid. Paid
1962	----	----	----	----	----	----	1.80
1961	526.8	342.4	15.1	5.64	21.51	5.61	3.60
1960	506.4	330.5	15.3	5.36	20.98	5.44	3.60
1959	498.5	329.9	15.0	4.93	19.59	5.08	3.00
1958	440.8	278.0	16.2	3.74	17.09	4.90	3.00
1957	408.8	257.2	15.8	3.39	15.76	4.50	3.00
1956	386.2	242.0	15.3	3.01	14.41	4.08	3.00
1955	283.2	157.0	18.7	2.03	11.53	3.63	3.00
1954	217.1	118.5	20.0	1.40	9.10	2.85	3.00
1953	294.9	157.1	19.9	1.59	12.42	3.90	3.00
1952	314.9	157.6	17.0	1.65	11.35	4.13	3.00
1939	73.3	35.5	27.9	.33	7.44	4.17	2.50
1938	64.2	31.4	27.9	.28	6.55	3.75	2.25
1937	55.6	27.1	28.1	.21	5.66	3.64	2.00
1932	2.6	----	----	----	.42	.34	.33½
1929	----	----	----	----	.43	.34	.33½

SOURCE: Philip Morris, Standard Listed Stock Reports, Standard and Poor's Corporation, March 1962, p. 1822.

TABLE 17

PERTINENT BALANCE SHEET STATISTICS

(millions)

Dec. 31	Gross Prop.	Capital Expend.	Cash	Inventory	Receivables	Current Assets	Current Liab.	Long Term Debt
1961	99.07	8.73	15.88	232.54	27.90	277.35	86.49	63.40
1960	93.64	7.30	11.80	209.33	27.38	249.82	60.36	65.40
1959	90.05	12.38	12.52	210.97	27.52	252.24	64.83	67.47
1958	65.49	7.58	23.16	211.79	22.35	257.31	115.58	29.40
1957	60.50	----	24.42	205.53	19.85	249.79	108.56	31.40
1956	56.28	----	22.43	207.68	19.94	250.05	110.16	33.40
1955	36.32	2.03	15.93	191.98	14.65	222.55	86.22	30.40
1954	35.55	1.68	9.41	180.93	13.61	203.86	62.85	32.00
1953	34.46	6.71	11.29	194.29	13.11	218.70	78.25	32.00
1952	28.73	3.50	10.36	193.75	12.75	216.85	81.80	32.00

SOURCE: Philip Morris, Standard Listed Stock Reports, Standard and Poor's Corporation, March 1962, p. 1822.

RATIOS OF PHILIP MORRIS INCORPORATED

Year	Current Ratio	Acid Test Ratio	Quick Ratio	Receivables Turnover	Productivity Ratio	Financial Ratio
1961	3.2 to 1	.53 to 1	.18 to 1	19 days	.05 to 1	-----
1957	2.3 to 1	.40 to 1	.22 to 1	14 days	.05 to 1	-----
1952	2.7 to 1	.31 to 1	.14 to 1	15 days	.04 to 1	-----

The current ratio is satisfactory and the acid test ratio reflects the large inventory of tobacco leaf which is a necessary part of the industry. The quick ratio indicates that the company might have to borrow from time to time to meet its current liabilities; however, receivables turnover indicates a very efficient credit department and although the productivity ratio is only 5 per cent, the cost of the company's international expansion is the principal reason and in the long run should increase the net income on a year to year basis.

The ratio trend over five year periods indicates a relatively stable position for the company with a gradually improving financial position.

R. J. REYNOLDS TOBACCO COMPANY

Reynolds Tobacco long the second largest factor in the industry, moved into the number one position in 1958 and has retained sales leadership in each of the past three years. Its Camels, Winstons and Salem brands are the largest selling regular, filter and mentholated filter brands respectively and cigarettes account for about 95 per cent of total tobacco sales with chewing and smoking tobaccos making up the remainder.

In 1961 Reynolds is estimated to have captured 34 per cent of the domestic market with Camels taking 13 per cent and 40 per cent of production, Winstons taking 12 per cent and 35 per cent of production and Salem with 8 per cent and 25 per cent of production. The company also produces Cavaliers and Brandon and Prince Albert smoking tobacco along with Days Work chewing tobacco, these latter two brands leading the field in sales.

In addition the company has the Archer Aluminum Division as a subsidiary and has extensive holdings in West Germany.

Sales have increased 8.1 per cent over the 1960 level the market and long term prospects are for continued growth and leadership in regular, filter-tipped and mentholated filter-tips.

Stock	Approx. Price	Dividend	Yield
Common	74 7/8	$1.60	2.1%
$3.60 Preferred	88	$3.60	4.1%

TABLE 18

INCOME STATISTICS AND EARNINGS

(millions)

Year Ended Dec. 31	Total Sales	Operating Expenses	Depr.	Net Income	Earnings	Divid. Paid
1962	----	----	----	----	----	.40
1961	1,532.8	----	11.83	117.25	2.91	1.40
1960	1,418.3	30.2	10.08	105.26	2.60	1.20
1959	1,286.9	29.5	8.77	90.36	2.23	1.05
1958	1,146.6	28.6	6.43	78.33	1.90	.92½
1957	1,053.3	25.9	5.10	64.16	1.54	.82½
1956	957.4	28.4	5.06	61.91	1.48	.77½
1955	866.4	27.8	4.17	53.27	1.27	.65
1954	814.3	25.4	3.41	44.83	1.05	.60
1953	876.2	23.8	2.68	34.17	.78	.50
1952	881.4	22.7	2.38	31.95	.72	.50
1939	276.7	25.0	1.19	25.64	.64	.57½
1938	282.3	22.4	1.14	23.73	.59	.57½
1937	303.0	----	1.04	28.22	.70	.71
1932	----	----	.99	33.67	.85	.75
1929	----	----	----	32.21	.81	.64

SOURCE: Reynolds, R. J., Standard Listed Stock Report, Standard and Poor's Corporation, March 1962, p. 1928.

TABLE 19

PERTINENT BALANCE SHEET STATISTICS

(millions)

Dec. 31	Gross Prop.	Capital Expend.	Cash	Inventory	Receivables	Current Assets	Current Liab.	Long Term Debt
1961	191.60	28.45	28.5	842.9	52.7	924.1	385.0	80.00
1960	165.40	26.78	29.0	743.3	50.7	823.1	325.3	86.00
1959	140.81	25.50	27.1	684.5	44.5	756.1	277.7	92.00
1958	119.80	23.87	29.6	594.9	37.0	661.5	206.7	98.00
1957	99.87	23.98	26.1	586.5	33.9	646.6	180.0	104.00
1956	78.69	8.72	23.7	557.2	30.2	611.1	147.6	110.00
1955	72.87	5.57	25.8	510.9	30.0	566.7	121.4	115.00
1954	68.34	7.51	23.3	523.6	26.9	574.0	144.9	120.00
1953	61.93	4.69	23.3	511.3	23.8	558.4	137.7	125.00
1952	58.37	4.10	21.0	506.5	25.7	553.2	137.2	130.00

SOURCE: Reynolds, R. J., Standard Listed Stock Report, Standard and Poor's Corporation, March 1962, p. 1928.

RATIOS OF R. J. REYNOLDS TOBACCO COMPANY

Year	Current Ratio	Acid Test Ratio	Quick Ratio	Receivables Turnover	Productivity Ratio	Financial Ratio
1961	2.4 to 1	.21 to 1	.07 to 1	12 days	.09 to 1	-----
1957	3.5 to 1	.33 to 1	.14 to 1	11 days	.08 to 1	-----
1952	4 to 1	.34 to 1	.15 to 1	10 days	.05 to 1	-----

The current ratio is not as high as many of Reynold's competitors but is still .4 above the absolute standard for 1961; however, the acid test ratio and quick ratio indicates that a high tobacco leaf inventory is being maintained and a small cash balance which might require periodic financing to meet current liabilities. The receivables turnover is excellent and the credit department is to be commended. The productivity ratio shows that this is a healthy, growing concern with good reason to be the leader of the industry.

There is no significant trend over successive five year periods in the ratio values; however, cash is becoming more critical and earnings to total assets is improving.

UNITED STATES TOBACCO COMPANY

United States Tobacco Company is the country's largest producer of snuff and it accounts for approximately 40 per cent of total output, which is slightly over 50 per cent of total volume of production and sales for this company.

In addition to Copenhagen snuff they produce smoking tobacco such as Model, Old Briar, Dills Best and others, chewing tobacco, cigars and Sheffield Oval Kings, Stratford Kings, Encore, Mapleton and Shis cigarettes.

Non-tobacco operations account for 30.6 per cent of total volume of business, and canned nuts, candy bars, pens and pencils are produced by subsidiaries.

Sales in 1961 rose to a new peak and 18 per cent above the 1960 level due principally to the products of its subsidiaries, and prospects for future growth and expansion are bright.

Tobacco products are expected to make slight future gains, and a development of interest is the production of private cigarette brands for Springfield Sugar and Products Company, a 180 store supermarket chain in New England.

Stock	Approx. Price	Dividend	Yield
Common	35 ¼	$1.55	4.4%
$1.75 Preferred	38 ¼	$1.75	4.5%

TABLE 20

INCOME STATISTICS AND EARNINGS

(millions)

Year Ended Dec. 31	Total Sales	Net Sales	Operating Expenses	Depr.	Net Income	Earnings	Divid. Paid
1962	----	----	----	---	----	----	.35
1961	45.3	40.7	18.7	.57	3.42	1.78	1.35
1960	38.2	35.3	20.4	.52	3.37	1.75	1.35
1959	32.3	28.9	25.0	.57	3.54	1.91	1.35
1958	29.8	26.2	29.0	.54	3.48	1.83	1.20
1957	28.2	24.9	29.0	.54	3.31	1.73	1.20
1956	27.7	24.5	26.9	.52	2.83	1.47	1.20
1955	27.9	24.7	26.0	.54	2.74	1.42	1.20
1954	29.3	25.7	22.5	.56	2.45	1.26	1.20
1953	32.0	27.2	24.9	.56	2.56	1.32	1.20
1952	30.2	26.1	25.5	.54	2.49	1.28	1.20
1939	18.3	14.2	27.8	.26	3.40	1.77	1.76
1938	18.3	14.2	26.4	.17	3.36	1.74	1.66½
1937	18.0	14.0	28.1	.13	3.46	1.80	2.06
1932	----	----	----	.12	3.54	1.91	1.10
1929	----	----	----	.12	2.77	1.30	.68

SOURCE: United States Tobacco, Standard Listed Stock Reports, Standard and Poor's Corporation, April 1962, p. 2360.

TABLE 21

PERTINENT BALANCE SHEET STATISTICS

(millions)

Dec. 31	Gross Prop.	Capital Expend.	Cash	Inventory	Receivables	Current Assets	Current Liab.	Long Term Debt
1961	16.97	---	5.1	25.8	2.1	33.0	9.6	2.07
1960	16.57	.50	6.0	23.1	2.1	31.2	7.9	2.10
1959	15.42	.43	5.8	19.1	1.6	26.5	3.5	3.31
1958	14.08	.30	9.0	18.4	1.2	28.6	3.8	3.78
1957	13.92	.31	7.6	19.2	1.2	28.0	4.0	4.38
1956	13.86	.35	4.6	20.9	1.2	26.7	3.8	4.78
1955	13.62	.19	3.8	23.2	1.2	28.2	4.1	6.80
1954	13.56	.69	4.2	22.9	1.2	28.3	4.1	7.60
1953	13.03	.61	3.8	24.3	1.2	29.3	4.7	8.00
1952	12.67	.78	6.1	24.3	1.3	31.7	15.3	Nil

SOURCE: United States Tobacco, Standard Listed Stock Reports, Standard and Poor's Corporation, April 1962, p. 2360.

RATIOS OF UNITED STATES TOBACCO COMPANY

Year	Current Ratio	Acid Test Ratio	Quick Ratio	Receivables Turnover	Productivity Ratio	Financial Ratio
1961	3.4 to 1	.75 to 1	.53 to 1	17 days	.07 to 1	-----
1957	7 to 1	2.2 to 1	1.9 to 1	45 days	.08 to 1	-----
1952	2 to 1	.5 to 1	.4 to 1	11 days	.05 to 1	-----

The current ratio and acid test ratio indicates a healthy current condition and the quick ratio indicates an adequate cash reserve. The credit department is excellent evidenced by receivables turnover at an average of 17 days for 1961, and the productivity ratio indicates that the company is a growing and successful one. United States Tobacco is the smallest of the companies analyzed but it is important to the tobacco industry for the production of products other than cigarettes.

The trend for ratios over five years shows significant fluctuations which can be accounted for by product variation and lesser stability than the larger companies analyzed.

CHAPTER VII

General Observations as Regards Monopoly and Oligopoly

The theory of price in a single firm monopoly assumes that the monopolist will establish a price-output combination that will maximize profits, and to do this the monopolist produces to that point where marginal revenue equals marginal cost; where the cost of the last additional unit completed is equal to the revenue obtained for that unit. For an oligopoly, the individual firms making up such a structure usually achieve an effective price-output relationship either with or without tacit agreement. The price-production structure of an oligopoly is as a rule somewhat less than that of a monopoly.(1)

A seemingly general belief is that tacit agreement in an oligopoly is not successful due to the changing practices of rival firms outside the limits of the agreement.(2)

The "Big Three" of the tobacco industry practiced to a certain extent a barometric firm price leadership; whereby R. J. Reynolds commanded adherence to its prices by rivals to the extent

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(1) Harriss, C. Lowell, The American Economy, (Richard D. Irwin Inc., Homewood, Illinois, 1959 3rd Edition), pp. 387-389.

(2) Bain, Joe, A Note on Pricing in Monopoly and Oligopoly, (American Economic Review, March 1949) pp. 448-450

that Reynolds reflected market conditions with reasonable promptness.(3)

As the price policy of the American cigarette industry is traced through the years, from the dissolution of the "Trust" to the Lexington, Kentucky Case, it appears that Reynolds maintained, to a certain extent, price leadership without an overt agreement. The necessary requirements of such an arrangement are:

(a) Firms few in number with circular dependence as to price and policy.

(b) Entry into the industry severely restricted in most instances.

(c) The commodity although not completely homogeneous in all cases, a close substitute.

(d) Demand for the product must be inelastic.

(e) Individual-firm cost curves must be similar.

These conditions existed for the cigarette industry and as a result Reynolds emerged as the price leader.(4)

From January 2, 1931 to the year of 1934 the firms engaged in the production of tobacco had a wide range of prices; however,

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(3) Markham, Jesse W., The Nature and Significance of Price Leadership, (Readings in Industrial Organization and Public Policy, Vol. VIII, Heblebower and Stockings 1958), p. 181.

(4) Ibid., pp. 185-187.

in the latter year they established a price of $6.10 per thousand cigarettes which seems to follow the definition of limit price. The oligopoly set this price for their product below that of maximum returns, but sufficient for normal profits or small excess profits. The long run view, was to produce without fear of additional competition, rather than to maximize their return over the short run with large excess profits, which would possibly attract additional competition through entry into the industry of competing firms.

The most frequent aim and desire of pricing goals is to achieve a target return on investment. A company may fix an arbitrary figure of ten per cent of net income to total assets and then estimate its average total cost and add some mark-up to the product in order to determine a market price at the desired level. There are a variety of explanations to justify pricing decisions. There is a desire for a reasonable return, a fair return in relation to risk factors, desire to exceed the average return over a recent period, anticipation of long-range yields and use of a specific profit target as a means of stablizing industry prices.(5)

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(5) Lanzillotti, Robert F., <u>Pricing Objectives in Large Companies</u>, (American Economic Review December 1958), pp. 923-931.

Another aim of large companies is the stablization of price and margins and if they have received normal returns when market conditions are only fair, they are willing to hold the price line during times of prosperity.(6)

Another goal or aim which determines price policy is a desire for a target market share. Large companies will for-go the possibility of short run excessive profits for a lesser profit and a larger share of the market sales; therefore, by pricing their product somewhat lower the quantity demanded will increase and they will capture a higher percentage share of the market.(7)

A policy which finds great favor with most companies in establishing a market price is that of meeting or matching competition. If the price range is set too high a competitor will undercut and capture most of the demand, and there is little reason to price below the competitor as this would cut the profit margin even though production and sales might increase somewhat.(8)

In determining market prices during the period between 1911 and continuing up to the present day, the production leaders of the tobacco industry, comprised of R. J. Reynolds, American

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(6) Ibid., pp. 931 and 932.

(7) Ibid., pp. 932 and 933.

(8) Ibid., pp. 934 and 935.

Tobacco Company and Liggett and Myers followed one or several of these policies in determining market price. With R. J. Reynolds as the price leader they raised prices, and when independent production cut into their target share of the market, they met the price of their competition by price cuts so that they might compete successfully with the independent brands.(9)

Merger and consolidation of single firms into a monopolistic corporation was practiced in the late nineteenth century. The decision of the Northern Securities Case in 1904 led to a dissolution of most of our countries large monopolies.(10)

Oligopoly mergers took place since these mergers of the second class could be performed within the boundaries of the Sherman Act.(11)

As for the tobacco industry, monopoly by merger was instituted by James B. Duke in the formation of the tobacco "Trust" which existed between 1890 and 1911, the date of the dissolution. Since 1911 all of the tobacco companies have expanded their holdings by

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(9) Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbilt University Press, Nashville, Tennessee, 1951), p. 111-117.

(10) Steigler, George J., Monopoly and Oligopoly by Merger, (American Economic Review, May, 1950), pp. 27 and 28.

(11) Ibid., Mergers of the second class were differentiated from primary mergers; primary being for monopoly and the second class being mergers for oligopoly. This class distinction is a set of terms peculiar to the author. p. 31.

means of consolidation and merger, but the operations were of the second class, that of oligopoly and not monopoly, since the practice of absolute monopoly has largely passed from the American scene.

In the manufacture of tobacco products, the second class merger and consolidation consist of the acquisition of related industries such as machinery, licorice, foil and some foreign holdings.

Demand is defined by Harriss as a schedule of the quantity of goods or services buyers will purchase at different prices. The demand curve is represented in a graph as a line sloping from left to right and downward. It is usually shown as a slightly curved or as a straight line.

The ordinary concept of the demand curve under realistic conditions of oligopoly in industry is not applicable; therefore the phrase "imaginal demand curve" which was suggested by Mr. Nicholas Kaldor is often used when considering demand under oligopolistic conditions.(12)

There are two possible situations which Sweezy discusses and diagrams that result in a "kinked" demand curve: when one of the firms in an oligopoly lowers its price without the knowl-

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(12) Sweezy, Paul M., Demand Under Conditions of Oligopoly, (Journal of Political Economy 1939), p. 568.

edge of its rivals its demand will be more elastic than that of its competitors resulting in a kink; when one rival, occupying the position of price leader, raises its price and, assuming that rivals also raise their prices to a lesser degree, the leaders demand curve will be less elastic than that of his competitors for a period of time resulting in a kink.(13)

Mr. Sweezy takes the position that the demand curve for oligopoly industries will, in most instances, be kinked; therefore, the question is raised as to the demand curve in the cigarette industry.

After the establishment of an oligopoly consisting of R. J. Reynolds, American Tobacco Company, Liggett and Myers and P. Lorillard in 1911 there were a series of price adjustments with R. J. Reynolds emerging as the upward leader and American as the leader for downward adjustments. These companies followed a practice of adjusting prices within a maximum period of five days to that price established by the leader which would in most instances result in a demand curve without the characteristic oligopoly kink.(14)

The characteristic absence of a kinked demand curve for the industry may have been one of the basic reasons underlying the

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(13) Ibid., pp. 569-571.

(14) Nicholls, William H., Price Policies in the Cigarette Industry, (The Vanderbilt University Press, Nashville, Tennessee 1950), pp. 88 and 89.

government prosecutions from 1940 to 1946. The demand curve for the tobacco industry was a resultant of imperfect competition being nearly straight and tending to be inelastic, due to the practice of price identity followed by the three major companies.

CHAPTER VIII

SUMMARY

There were two critical periods in the development of the tobacco industry in general and the cigarette industry in particular and they were the periods from 1890 to 1911 and 1940 to 1946.

In 1890 James Buchanan Duke merged five tobacco companies into one large organization, The American Tobacco Company and through highly competitive practices in advertising, sales and product differentation virtually eliminated his small-scale rivals and developed the Tobacco Trust into nearly a complete monopoly. This operation spanned a period of twenty years. In 1911 the Federal Government prosecuted the Trust under the Sherman Anti-trust Act, and the result was a decision forcing dissolution of the Trust. Using a plan devised by James B. Duke, the Trust was split into four major companies, R. J. Reynolds, Liggett and Myers, American Tobacco Company and the P. Lorillard Company, and a close knit oligopoly was established for the manufacture and sale of tobacco products.

From 1911 to 1940 several independent companies entered the field of enterprise notably Raleigh and Philip Morris Inc.; however, events led to further prosecution of the tobacco industry in the Lexington, Kentucky Case of 1940-1946. Eight organizations were indicted. R. J. Reynolds, Liggett and Myers and the American Tobacco Company, were indicted and were charged with conspiracy in restraint of trade, monopoly, attempts to monopolize and conspiracy to monopolize. The other companies entered a plea of "nolo contendere" and were subject to the findings against the big three. Prosecution was based on the Sherman and Clayton Anti-trust Acts and new ground was broken in the courts interpretation and application of the laws. The defendants were found guilty as charged and were assessed a total fine of $255,000.

The government had won a signal victory but the companies were at loss as to operations procedures that they should adopt to stay within the boundaries of the law. From 1946 to 1962 there have been no Anti-trust suits brought by the government against the tobacco industry; therefore, it can be assumed that the companies as a whole have adopted sound business practices within the letter of the law.

An analysis of the current position of the major tobacco companies shows them to be in a healthy growing position and the outlook in both the short run and long run promises to be generally favorable to the industry.

The structure of the industry is that of an oligopoly with some domination by R. J. Reynolds, Liggett and Myers and the American Tobacco Company.

There is strong oligopolistic rivalry among the tobacco producers as to advertising and product differentation and R. J. Reynolds is the generally accepted price leader of the industry.

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Dr. V. O. Johns was of valuable assistance in the revision of the first draft of the thesis. His comments and suggestions are included in the context and contribute to a more complete and accurate presentation of the subject matter.

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VITA

The author was born in Morgantown, West Virginia on October 24, 1925 and attended public schools here until 1942 when he entered Greenbrier Military School graduating in 1943. He was selected for the Navy V-12 Training Program and later for Naval Reserve Officers Training Corps and attended Bethany College and the University of South Carolina from which he graduated in October 1945.

He transferred to the Supply Corps and attended Harvard University for five months to study in the Naval Supply Corps School and upon completion of studies was assigned as Assistant Receiving Officer, United States Naval Shipyard, Terminal Island, California. He served as Supply Officer of the U. S. S. Epping Forest LSD-4 and U. S. S. Mervine DMS-31 before returning to West Virginia University for further schooling in 1948.

In the period from 1950-1951 he again entered the Naval Service serving as Inventory Officer, Tacoma, Washington Sub-Group of the Pacific Reserve Fleet and as Supply Officer of the U. S. S. Ajax AR-6 and U. S. S. Passumpsic AO-107.

He worked for sometime at the Hercules Powder Company, Radford, Virginia as Foreman Trainee and in Industrial Contol before enrolling in Virginia Polytechnic Institute for a course leading to a Master's Degree in Business Administration.

Charles V. Wilson Jr.

Charles V. Wilson Jr.

ABSTRACT OF THESIS

A history of tobacco and its use by the Indians of South, Central, and North America is discussed and its gradual spread of use to Spain, England and the Continent is given.

The formation of a monopoly by James B. Duke in establishing the American Tobacco Company, and the price policies, product differentation and advertising expenditures used in the development of the Trust is discussed. The Sherman and Clayton Anti-trust Acts are presented and their use in the dissolution of the trust and the establishment of an oligopoly are covered extensively.

The Lexington, Kentucky Case of 1940-1946 shows the tobacco industry again prosecuted by the government for conspiracy in restraint of trade, monopoly and attempts to monopolize resulting in a decision against the eight companies indicted and the assessment of fines totaling $255,000. The companies developed business practices after this trial that would enable them to stay within the letter of the law and have successfully avoided prosecution from 1946 to 1962.

The current financial positions of the major tobacco companies is given and the long run prospects of the tobacco industry are those of gradual growth and expansion based on an increase in population and the growth of national income as regard domestic sales and expansion of foreign trade by nearly all of the major producers.

Finally some general observations concerning monopoly and oligopoly are given and their relationship to the tobacco industry as a whole are explained.