Tobacco industry in the Czech Republic

Markéta Lőrinczy, Ing., Management department, Mendel University in Brno, marketa.lorinczy@gmail.com

Abstract
Among the tobacco industries in Europe, the one in the Czech Republic has the poorest controls. The collapse of communism in 1989 allowed many changes in the different markets. A big change occurred in the tobacco industry of Czech Republic as well. During the communist era it was impossible for international companies to enter. However, after the collapse, tobacco companies abused this opportunity not just to enter but also to have very strong word in reforms. Transnational companies were able to react very fast which provided leader position for some of them in this market. The Czech Republic was a really crucial market for the others due to the central location in Europe therefore many unethical manners were used to get in.

This paper examines Czech tobacco market and moreover transnational tobacco companies (TTCs) and their efforts to influence reforms and creation of new policies in the Czech Republic. The aim of this document is to describe the overall situation of the tobacco market in the Czech Republic with its specifications, characteristics and uniqueness. The paper will be used for further comparison of tobacco markets in Slovakia, Poland and Hungary which will help the research for International Visegrad Fund.

Key words
Tobacco industry, market share, transnational tobacco companies, cigarettes, Philip Morris, British American Tobacco

Introduction
With unbelievable speed and success, Europe is reaching to implement EU directives to control the tobacco in Europe. In 2004, the Czech Republic joined the European Union (EU) which brought different tobacco policy along, being this, according to EU rules, very weak. At the same time, the Czech Republic is the only EU member that has not yet ratified the Framework Convention on Tobacco Control (FCTC).

In 1991, Czech government initiated a process of privatising tobacco monopolies; multiple TTCs (Philip Morris, British American Tobacco (BAT), Rothmans, R.J.Reynolds, etc) prepared the strategy to enter to market, which was important due to its Central European location. (1) Both PM and BAT tried to shape tobacco tax system as a core factor towards market share. (2) Philips Morris (PM) had closer working relationship with Czechoslovakian government and when Tabak was put out on tender, PM (through a licensing agreement established in 1987 to produce PM’s most prominent brand, Marlboro) acquired a 30% of share. By 1993 PM had gained a majority of holding (67,4%) and monopoly over the tobacco market in the Czech Republic. (3) (4)

Present paper examines the Czech tobacco market. It compares transnational tobacco companies present in this particular market and describes uniqueness of tobacco industry in one of the Central European countries and it also shows the power of tobacco companies on
Czech government. The aim is to prepare general analysis that would be used as a material for International Visegrad Fund. Nevertheless, only limited literature focuses on this topic and strong lobbies in the Czech Republic do not allow to have deeper information.

Objectives and methodology

This study used a qualitative method based on analysing internal tobacco documents. These data were supported by legal Czech documents and European Union directives. Additional sources such as market researches, journals and statistical results were used to provide more recent data. In the present paper only secondary data are used and these are analysed to give general overview of the industry.

Results

Tobacco market in the Czech Republic

The Czech tobacco market grew fast in the period 2006-2010 thanks to strong sales growth in the category of cigars and cigarillos. Overall market growth is expected however the last 2 years had a decreasing trend. The Czech Republic accounts for 1% of the European tobacco market.

In 2010 tobacco market grew by 1.5%, it has generated total revenues of $2.2 billion. The forecast for 2015 is counting with 6.9% increase which would generate over $2.4 billion. (5)

The most lucrative market is the segment of cigarettes, generating $2.2 billion which was equivalent to the 93% of total market value in 2010. This is matter of notably high rate of smoking (35% of men and 27% of women smoke), policy supporting tobacco industry and still low cigarette prices (excise tax is 2.10 CZK/piece and average price of cigarette package is 70 CZK) compared to other European nations. (6) (7) (8)

![Graph 1: Czech Republic tobacco market value](chart.png)
Transnational companies

When the communist system collapsed, TTCs had the opportunity to enter the Czech tobacco market. The new participants created political crisis, produced legislation which encourages fraud and corruption and have led to the development of advertising standards which are either impossible or difficult to enforce. The central market was so important that TTCs created new strategies to be the first to enter and influence new economic reforms. Because of the powerful lobbies, Czech Republic has one of the weakest tobacco controls led by TTC. (9)

TTCs’ measurements were towards new taxation system (tax stamp system), advertising law (advertising ban), excise taxes and delaying EU directives in the Czech Republic which would help them to generate higher profits. (10)

Philips Morris

Philips Morris International (PM) is the leading player in the Czech tobacco market, generating a 71% share of the total market value. Philip Morris generated 6 billion in first ½, 2013. CZK and net income was 0.9 billion. CZK, a decrease of 4.1%. (5)

PM is engaged in the manufacturing and sales of cigarettes and other tobacco products. The company’s products are sold in over 180 countries under various brand names including Marlboro, Philip Morris, and Red&White. PM’s product portfolio includes a wide range of premium, mid-price, and low-price brands that comprise both international and local brands. In the Czech Republic and Slovakia it owns a local brand under the name Petra. (9)

PM’s strategy was to have very good working relationship, this fact allowed to gain the majority of Tabak a.s. factory thus hold monopoly power over the Czech tobacco market. (4)

Graph 2: Market shares

British American Tobacco

British American tobacco was repeatedly lobbying to enter the Czech tobacco market. In 1995 they got the permission to establish a small facility. From the beginning, the key factor was to change excise tax to mixed excise tax due to their diverse price portfolio. However, the government set proportional excise taxes which were in line with PM’s preferences and therefore by 2000 PM had achieved 80% of the market. (2)
British American Tobacco (BAT) is engaged in the manufacturing and sales of cigarettes and other tobacco products. The company owns a portfolio of over 200 brands of products such as cigarettes, cigarillos, roll-your-own tobacco, pipe tobacco and smokeless snus. It operates in 180 markets.

The company’s product portfolio comprises of four global brands such as Dunhill, Kent, Lucky Strike, Pall Mall, and Vogue in the premium segment and Viceroy a low price international brand. (11)

**Imperial Tobacco Group PLC**

Imperial Tobacco Group (ITG) is engaged in the manufacturing, marketing and sales of cigarettes, tobaccos, cigars, rolling papers and tubes. It is present in 160 countries. The key brands include Davidoff, West, Gauloises Blondes, Drum, Golden Virginia, JPS, Fortuna, Gitanes and Rizla. The main activities are tobacco (marketing, manufacturing and sales of tobacco products) and logistics.

ITG operates 31 cigarette factories, 18 other tobacco product processing factories and 2 rolling paper factories. (12)

ITG is the third main player on the tobacco market. Its strategy is to follow Philip Morris, leader of the Czech market.

**Trends**

The consumption of cigarettes has decreased by 1% in the last 5 years. In 2012, for the first time, it was 2%. This fact mainly influenced PM, however, due to export and higher domestic price of cigarettes, it could still generate 12% more profit than in 2011. On the other hand, Imperial tobacco was profiting from hand rolling tobacco products as well. The “roll your own” cigarette products (RYO) started to be popular among young people who can afford increasing prices of popular brands. (14)

In 2013, there was another increase of excise tax of cigarette from 2, 10 CZK to 2,50 CZK per package. This increase was for lower quality cigarettes but for premium brands the same was between 3 – 4 CZK/package. The increase allowed companies to raise their margin however the value of the market is expected to lower by 4%. (15)

In the summit of Visegrad Group, Czech Republic stated that disagrees with European directives about higher control of cigarettes. Poland joined this opinion. The Czech and Polish government expressed fear that this would lead to outflow of tobacco companies from Central Europe and therefore decrease of working places. (16)

European commission has been pushing member states to prohibit slim cigarettes, cigarettes with flavour (vanilla, menthol, etc.) and change the package of cigarettes. The 65% of the package should be covered with warning in each language. (17)

**Conclusion**

The Czech tobacco market seems to be quite small, however, in terms of sales and profit, has a significant value for tobacco companies. Not only central position was the key factor for new entrants but also changing winds in Czech political regime.

With the entry, TTCs established new trends in politics which was so successful that tobacco companies are still influencing Czech law system. Even though, Czech Republic adopted among the last member states the European law about higher control of tobacco that does not allow cooperation among tobacco companies and government employees. Czech government added a new clause to WHO about exemption of cooperation. For the same
reason, TTCs are part of the new excise tax system being able to influence the law according to their interest. Miroslav Kalousek said that this way he was able to change the law in the way that all companies would be in the same position.

Obviously, Czech tobacco market is unique. Not only low price of cigarettes, exemptions in European directives adaptation, higher number of smokers (also young people under 16) are very specific in tobacco market, but also peculiar relationship between government and tobacco companies. In British University in Bath a scientific study was created about this phenomenon.

The aim of this paper is to analyze Czech tobacco market according tobacco companies, law system, trends and market characteristics. However, for Czech market there are not enough studies due to strong censure from tobacco companies. For further information, the “not very communicative” tobacco companies need to be directly contacted.

References


