

DIFFERENCES BETWEEN THE STRATEGIES OF THE TWO LEADING TOBACCO COMPANIES OPERATED IN THE CZECH REPUBLIC

LUCIE JELÍNKOVÁ

Abstract: This paper deals with analyzing of the structure of the tobacco industry in Czech Republic and strategies of two major competitors in the industry. Specifically, the Philip Morris ČR, Inc. and British American Tobacco Czech Republic, Ltd. are analyzed. At first, a characteristic of the tobacco industry, including the description of basic external factors influencing the companies in this sector, such as the nature of the industry, competitors and their market shares, product demand, regulation and taxation of the tobacco industry is stated. Subsequently, selected companies are briefly describing. It is characterized their competitive strategy and is stated what they are doing to improve their current competitive position and what mistakes they make or where they are vulnerable. In the paper is also indicated likely development of the sector and the response of companies. In conclusion are listed the recommendations for these companies regarding their current strategies.

Keywords: tobacco industry, strategies, competitors, external factors, position

JEL Classification: M12, M21

1. INTRODUCTION

This paper deals with analyzing the structure of the tobacco industry in Czech Republic and strategies of two major competitors in the industry. Specifically, the Philip Morris ČR a.s. and British American Tobacco Czech Republic, s. r. o. are analyzing. At first, it is state a characteristic of the tobacco industry, including the description of basic external factors influencing the companies in this sector, such as the nature of the industry, competitors and their market shares, product demand, regulation and taxation of the tobacco industry. Subsequently, selected companies are briefly describes. It is characterized their competitive strategy and is stated what they are doing to improve their current competitive position and what mistakes they make or where they are vulnerable. In the paper is also indicated likely development of the sector and the response of companies. In conclusion are listed the recommendations for these companies regarding their current strategies.

2. TOBACCO INDUSTRY ANALYSIS IN THE CZECH REPUBLIC

Generally, the situation in the tobacco industry is rapidly changing and is completely dependent on the law and legal constraints of the country. As significant external factors that companies influence in this sector can be considered:

- the nature of the industry in which the Company operates;
- competitors in the industry and their market share;
- demand for products, customers and their sensitivity to price changes;
- regulation and taxation of the tobacco industry.

Market of tobacco products in Czech Republic has a purely oligopolistic nature.

For more than 12 companies engaged in the manufacture, sale or distribution of tobacco products exist on the Czech market (Kamená, 2011). As significant

competitors who perfectly dominate the market and control it, can be considered three companies, which control about 90% of the market. Philip Morris ČR has the largest share of the market, then follow British American Tobacco, Imperial Tobacco and Japan Tobacco International. Shares of each company are shown in the following graph (PMI Annual Report, 2016).

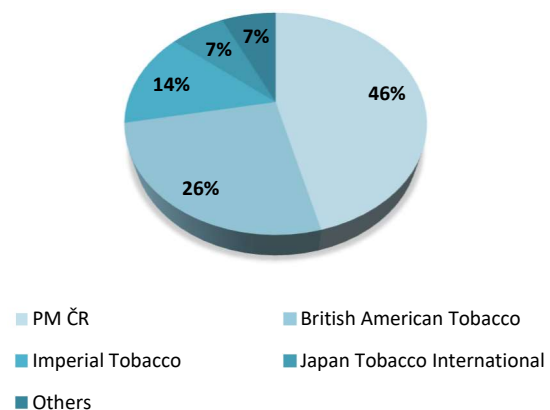


Figure 1 Graph of the market shares of the tobacco industry in the Czech Republic in 2016

Source: PMI Annual Report, 2016

An important role in the competitiveness of these enterprises also plays a portfolio of their products (see Table 1).

Table 1 Summary of portfolio tobacco companies

Name	Number of brands	Number of variants
Philip Morris ČR	9	68
British American Tobacco ČR	10	47
Imperial Tobacco ČR	14	48
JT International ČR	12	38

Source: Kamená, 2011

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Table 2 Market share of PMČR

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Market Share	67,7	62,6	60,8	56,0	55,5	54,5	51,9	50,7	48,6	47,4	45,9

Source: PMI Annual Reports

The table shows that only 4 companies offers over 200 types of cigarettes. If we consider that the tobacco industry are very limited possibilities for differentiation, as well as marketing support and price formation is regulated by the state, it is the opportunity to significantly differentiate products from the competitors only minimal. However, if company create several brands that will have a strong position in the market and cover all price segments and taste of smokers, there will be awareness of adult smokers much higher (Kamená, 2011).

Czech Republic has one of the highest percentages of regular smokers among OECD member states. Among the 35 Member States, Czech Republic finished in tenth place. In comparison with previous years, the proportion of so-called daily smokers is descending. Simultaneously, 22.3% of adults (Kohoutová, 2016). The demand for tobacco products in Czech Republic is significant. People smoke here nearly 21 billion cigarettes (PMI internal materials, 2015).

Sector of the tobacco industry can be described as neutral, since it is not influenced by economic cycles. Cigarette consumption is not limited even in times of financial crisis, however, is recorded shift to cheaper brands of cigarettes, thereby is creating pressure on firms and markets (Zahradníček, 2011).

The forecast for market development is directed to further increases in excise tax. In my opinion, to maintain the competitiveness of enterprises is crucial that their products met the following basic criteria: low price, high quality, popular brand.

3. DESCRIPTION OF COMPETITIVE STRATEGY

3.1 Philip Morris ČR

This company is subsidiary company of Philip Morris International, which operating in approximately 160 countries worldwide. Currently, the PMČR is the largest producer and marketer of tobacco products in the Czech Republic. The company is engaged in manufacturing, packaging and distribution of cigarettes and supply semi-finished goods to internal and external customers. PMČR operates primarily on Czech and Slovak markets, but also focuses on exports, which is implemented under the 55 markets in the world, where PMI operates (Internal materials, 2015).

Strategy of this company is primarily based on PMI Strategies for Growth, which includes these points (PMI Annual Report, 2016):

- Reinforce our position in profitable adult consumer segments
- Drive growth of our leading brand portfolio through enhanced consumer understanding, innovation and a new commercial approach
- Expand geographically
- Obtain a fair and reasonable fiscal and regulatory environment
- Pursue opportunities for margin improvement

- Generate cost savings and boost organizational effectiveness
- Develop and implement a comprehensive plan to counter the threat from illicit trade
- Develop and commercialize Reduced-Risk Products
- Effectively utilize our strong cash flow to increase shareholder returns
- Attract, motivate and retain the best global talent

In accordance with the company's effort focus on maximize performance and increase flexibility in order to increase the competitiveness of the company has changed the operating model in production. From 1 January 2015 the company operates as a provider of manufacturing services (PMI Annual Report, 2016).

In recent years PMČR has changed its strategy and began to focus more on low segment. However, the company still focuses largely on medium and premium segment, which give more profit margin than low segment. The aim of the company is primarily focusing on product quality and high standard of products.

This fact is the reason constantly diminishing market share, as can be seen from the following table (Table 2).

The cause of this decrease can be attributed to the competitive pressure to reduce price and availability of cheaper brands offered by competitors.

If we look at decomposition of market share of PMČR, which is shown in the graph below, we can see that a low segment is about half of all portfolio. In the event that the company is focusing more on low segment in its portfolio, it would mean probably stagnation or even increase its market share. It would, however, completely contrary to the values that the company has set itself and the strategies we use, given that the aim of the company is primarily focusing on product quality (PMI Annual Report, 2016).

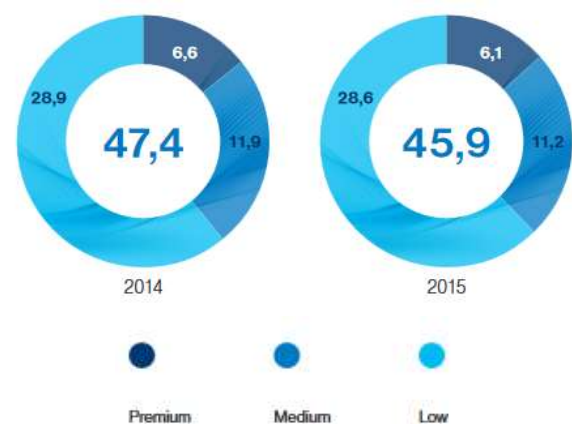


Figure 2 The amount of market share in the allocation to the segments in 2014 and 2015

Source: PMI Annual Report, 2016

Strategy listed above also reflects business risks, which include: significant increases in cigarette-related taxes; the imposition of discriminatory excise tax structures;

fluctuations in customer inventory levels due to increases in product taxes and prices; increasing marketing and regulatory restrictions, often with the goal of reducing or preventing the use of tobacco products; health concerns relating to the use of tobacco products and exposure to environmental tobacco smoke; litigation related to tobacco use; intense competition; the effects of global and individual country economic, regulatory and political developments; changes in adult smoker behavior; lost revenues as a result of counterfeiting, contraband and cross-border purchases; governmental investigations; unfavorable currency exchange rates and currency devaluations; adverse changes in applicable corporate tax laws; adverse changes in the cost and quality of tobacco and other agricultural products and raw materials; and the integrity of its information systems. PMI's future profitability may also be adversely affected should it be unsuccessful in its attempts to produce products with the potential to reduce the risk of smoking-related diseases; if it is unable to successfully introduce new products, promote brand equity, enter new markets or improve its margins through increased prices and productivity gains; if it is unable to expand its brand portfolio internally or through acquisitions and the development of strategic business relationships; or if it is unable to attract and retain the best global talent (Calantzopoulos, 2013).

3.2 British American Tobacco Czech Republic

This company is a subsidiary company of British American Tobacco, which is after Philip Morris International, the second largest in the world and sells its products in more than 200 countries. The company owns 46 factories for the production of tobacco products in 39 countries. The most famous brands of the company include Lucky Strike, Pall Mall, Dunhill, Kent, Viceroy and others. In recent year, the share of this company increased by more than 4%. Big breakthrough meant the introduction of the Viceroy brand in 2005. The brand belongs to the segment of extremely low prices, and in this segment represents considerable competition in Czech market (BAT, Annual Report, 2015).

Strategy of this company is based on growth, productivity, responsibility and building a winning organisation. The Vision of this company is to achieve leadership of the global tobacco industry. In the area Growth, the company want to increasing its volume and value share of the global tobacco market through organic growth and mergers and acquisitions. In the area Productivity is the goal to effectively and efficiently deploying global resources to increase profits and generate funds to reinvest in business. For ensuring a sustainable business want company balancing commercial objectives with the expectations of a broad range of stakeholders. The company knows that is very important for fulfilment all goals is necessary to ensure the right people and effectively them manage. The success of the strategy lies mainly in power of brands, innovation in new products and product categories, geographic distribution markets in which company operates and talented people (BAT, Strategic report, 2015).

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This company has balanced portfolio (premium, mid-price and low-price segment) and innovative brand portfolio across geographies. The company believes that this strategy to allow its to build strong consumer loyalty through in every time (BAT, Annual Report, 2015). Innovation brand portfolio represent next generation products, which include: Vapour Products (e-cigarettes), battery-powered electronic devices which heat a solution to create a vapour which can be inhaled; Tobacco Heating Products, devices designed to work with specifically engineered cartridges, containing tobacco, to deliver a real tobacco taste and aroma; and Licensed Medicinal Products, licensed nicotine products to help smokers reduce, replace or stop (BAT, Strategic report, 2015).

Strategy listed above also reflects BAT business risks, which include: competition from Illicit trade; Excise shocks from tax rate increases or structure changes; in Financial area: Liquidity risks, including capital structure and leverage, Management of cost base, Foreign exchange rate exposures, Counterparty risks and Retirement benefits (all these factors can have potential impact on Productivity - capital effectiveness), Wrongly valued acquisition opportunities, which can have potential impact on Growth (mergers and acquisitions); in Marketplace: Inability to obtain adequate supplies of leaf, Economic crisis impact on secondary supply chain, Trading environment, Trading performance in key markets (all these factors can have potential impact on Growth); in area Regulation: packaging and labelling, advertising and promotion, design, contents and emissions of products, testing and measuring, public place smoking, and industry participation (all these factors can have potential impact on Growth); in Litigation: Loss of a smoking and health-related court case, which can have Potential impact on Productivity (capital effectiveness); in area Data: Disruption to the Group's information technology systems, Loss of confidential information or malicious manipulation of data (potential impact on Productivity) (BAT, Annual Report, 2015).

4. CONCLUSION

In my opinion, the market with tobacco products is heavily influenced by increasing the excise tax, which is reflected in a rising share of cheap brands and illegal market. Consumer preferences are changed in recent years. The market of tobacco products is oversaturated with brands in all price segments. Only a few of them have a higher position. Companies should focus on the creation of several strong brands in all three-price segments and broaden or narrow their options to satisfy current consumer preferences. This will make it possible to reduce the cost of production, distribution, marketing and focus on building and growth of key brands that the company will generate higher profits. Great emphasis should be placed on supporting brands in the low-cost segment, whose importance continues to grow.

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Lucie JELÍNKOVÁ, Ing., Ph.D., MBA

University of Žilina, Faculty of Informatics and Management Science, Department of Managerial Theories

Univerzitná 8215/1, 010 26 Žilina, Slovakia

e-mail: lucie.jelinkova@fri.uniza.sk