The Tobacco Sector in Poland vs. the Czech Republic: an Analysis of the Impact of the Global Financial Crisis

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ABSTRACT

The paper presents a summary of the problems inherent in the tobacco sector in Poland and the Czech Republic, and analyses the impact of the global financial crisis on the growth of the industry. The paper commences with a market analysis of the sector in Poland and the Czech Republic, describing the key players involved and their respective market share; we then go on to compare the sectors in both countries, analysing in detail the impact of the crisis upon them. The main part of the paper concentrates on the impact of the global financial crisis on the sector in both countries. We also present two-year forecasts regarding growth in the industry. The conclusion of the paper is that the global financial crisis did not significantly influence the sectors and that the decrease in the consumption of tobacco products was mostly the result of other factors, such as a change in lifestyle and the effects of the ‘grey’ (parallel) market.

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1. Introduction

The tobacco industry is an important sector in the global economy, generating sales of almost $721 billion in 2010 according to MarketLine. Cigarettes represent the leading market segment with revenue exceeding $681 billion, which accounts for almost 95% of the overall market. The yearly rate of market growth is expected to accelerate to 4.5% until 2015, bringing the market to almost $890 billion [21].

The tobacco market involves the retail of tobacco, cigarettes, cigars, cigarillos and chewing tobacco. There are currently around 1.3 billion smokers in the world; this figure is expected to climb at a rate of almost 4% per year. Tobacco is grown in over 120 countries worldwide, using close to four million hectares of the total agricultural land available on a global scale. Around 12 million cigarettes are smoked every minute around the world. It is worth adding that around 35% of men in developed nations smoke, compared with 50% of men in developing nations. It is estimated that about 22% of women smoke in developed nations, compared with less than 10% in developing nations.

There are but a few branches in the world which exhibit such a wide global reach as the tobacco sector. The tobacco industry plays an important role in the economy of more than 100 countries, providing employment to millions of people around the world. The European tobacco sector can be said to be vitally important from the point of view of national economies and the entire European Community. It is estimated that it covers 85,000 cultivations of tobacco, in which 320,000 employees are employed in growing and processing and 50,000 in the manufacturing of cigarettes [23]. In other words, the tobacco industry is an important factor in both the economic and social spheres. It is worth noting that even in those few countries that do not have their own tobacco industry, the distribution of tobacco products is an important area of economic activity.

The tobacco sector has undergone significant transformation in recent years. There are several main reasons for this development, two of which are indisputable. The first reason relates to the regulatory change and increasing stringency of each state towards tobacco manufacturers and smokers (lawsuits around the world against cigarette producers, the prohibition of smoking at airports, restaurants, workplaces, etc.). The second issue is directly related to the economic crisis, which has continued unabated since 2008. On the one hand, this has brought about a significant pauperization of the inhabitants of some countries and a decline in their purchasing power. This especially applies to the south of Europe (Spain, Greece), and the Baltic countries, which have traditionally been regarded as major consumers of tobacco products. On the other hand, one has to keep in mind that in a time of budgetary problems, national governments seek ways to increase their revenues, in which raising tax rates and an increase in excise taxes are the most commonly used tools. It should be remembered that as recently as 2011 the state budget revenues from excise duties

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and VAT on tobacco products in Poland amounted to approximately 23.5 billion PLN [16]. Taxes which are levied on tobacco products are the main source of income of almost every budget throughout the world. In Poland, to give an example, almost 10% of all proceeds are earned thanks to the tobacco industry. Although the number of cigarettes sold in Poland has been steadily declining since 2006, the nominal value of the market has increased because of the continuous increase in excise tax [5].

In turn, in the Czech Republic the consumption of cigarettes has decreased by 1% over the last five years. Mainly due to the effects of the economic crisis, revenue from the sale of cigarettes decreased by 0.6 billion CZK from 2009 to 2011 [9]. In 2012 the state budget revenues from excise duties in the Czech Republic was 47 billion CZK and this which has increasing tendency. The Czech Republic has also experienced positive growth in the tobacco market [25] which is not surprising due to the increased prices of tobacco products.

2. Basic information regarding the tobacco sector in Poland

Poland is the largest tobacco manufacturer and the second largest producer of tobacco in the European Union, and is the northernmost country in which tobacco is grown on an industrial scale. Tobacco growing is carried out on an area of over 15 thousand hectares, and on approximately 10 thousand farms. The average amount of land allocated to the production of tobacco growing on farms from 2006 to 2009 was 1.2ha, but in recent years there has been a minimal increase to approximately 1.6ha. One estimates that more than 90% of manufacturers of tobacco are members of 11 associations of agricultural producers [12]. Polish climatic conditions are not conducive to the cultivation of tobacco, which means that obtaining raw materials of a good quality has proven problematic.

In the years 2006-2009, Poland produced between 39.5 and 43 thousand tons of raw tobacco on an annual basis. In the unfavourable conditions of 2010 (due to floods and flooding), tobacco production declined to 31.3 thousand tons. In 2013, 39.5 thousand tons of raw tobacco was contracted. The predominant type of light tobacco cultivation is Virginia [8], which constitutes about 67% of the crops, and clear tobacco. Burley type tobacco, occupying about 26% of the acreage of these crops, occupies second place. The number of workers employed in the cultivation of tobacco in Poland is currently estimated at around 45 thousand people, and an additional six thousand people work in six cigarette-producing plants which belong to leading tobacco corporations, such as Philip Morris and British American Tobacco.

The tobacco market in Poland is presented in Table 1. As the table shows, a slight growth in the tobacco market in Poland over recent years can be observed.

### Table 1. Poland tobacco market value

<table>
<thead>
<tr>
<th>Year</th>
<th>$ million</th>
<th>zł million</th>
<th>EUR million</th>
<th>% growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>5681.2</td>
<td>17168,9</td>
<td>4289,2</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>5752.7</td>
<td>17385,2</td>
<td>4343,2</td>
<td>1,3</td>
</tr>
<tr>
<td>2008</td>
<td>5816.3</td>
<td>17577,2</td>
<td>4391,2</td>
<td>1,1</td>
</tr>
<tr>
<td>2009</td>
<td>5882.4</td>
<td>17777,1</td>
<td>4441,1</td>
<td>1,1</td>
</tr>
<tr>
<td>2010</td>
<td>5946.5</td>
<td>17979,6</td>
<td>4489,5</td>
<td>1,1</td>
</tr>
</tbody>
</table>

Source: [24].

The tobacco market in Poland is highly concentrated and divided in the main into a very few companies. However, the whole sector is controlled by the leading global manufacturers (figure 1). Philip Morris is the leading player on the market, generating a 39,1% share. Its brands include: Marlboro, Players, L&M, etc. Second place is held by British American Tobacco plc (28,4 %) and third place by Imperial Tobacco group plc. (22,3 %). The other companies collectively hold just a 10,3 % stake in the market.
Cigarette sales proved the most lucrative for the Polish tobacco market in 2010, generating total revenues of $5.6 billion, equivalent to 94.5% of the market's overall value. In comparison, sales of loose tobacco generated revenues of $326.9 million in 2010, equating to 5.5% of the market's aggregate revenues.

3. Basic information regarding the tobacco sector in the Czech Republic

The collapse of communism provided transnational tobacco companies (TTC) with the opportunity to enter the Czech tobacco market. It has been claimed that the new representatives created a political crisis, by producing legislation which has encouraged fraud and corruption and has led to the development of advertising standards which are either impossible or difficult to enforce. The central market was of such vital importance that TTC created new strategies to become the first entrants to the market and to influence new economic reforms. Despite the powerful effects of lobbying, the Czech Republic has some of the weakest tobacco controls led by TTC [14].

In 1991, the Czechoslovakian government initiated the process of privatising tobacco monopolies; multiple TTCs such as Philip Morris (PM), British American Tobacco (BAT), Rothmans, R.J.Reynolds, and others prepared a strategy for entering the market, which was considered important because of its location in Central Europe [20]. Both PM and BAT tried to shape the tobacco tax system as a core factor towards market share. Philip Morris had a closer working relationship with the Czechoslovakian government and when tobacco was put out for tender, PM (through a licensing agreement established in 1987 to produce PM's most prominent brand, Marlboro) acquired a 30% share [1]. By 1993 PM had gained a majority of market share (67.4%) and had achieved monopoly over the tobacco market in the Czech Republic.

The Czech Republic accounts for 1% of the European tobacco market. The most lucrative market is the cigarette segment, generating $2.2 billion which in 2010 was equivalent to 93% of the overall value of the market [10]. Such figures can be explained by the notably high rate of smoking (35% of men and 27% of women smoke), policy supporting the tobacco industry, and cigarette prices remaining low (excise tax is 2.50 CZK/item and the average price of a pack of cigarettes is 70 CZK) in comparison to other European nations [3, 13].

TTC thus took steps towards a 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 [11]. Currently the main leaders on the tobacco market in the Czech Republic are Philip Morris, British American Tobacco, and the Imperial Tobacco Group plc. (figure 2).

![Figure 2. Leaders of the tobacco market in the Czech Republic in 2012](image)

Philip Morris International (PM) is the leading player in the Czech tobacco market, generating a 71% share of the total value of the market. Philip Morris generated turnover of 6bn CZK and net income of 0.9bn CZK, a decrease of 4.1% [9]. PM’s product portfolio includes a wide range of premium, mid-price, and low-priced brands that comprise both international and local brands. In the Czech Republic and Slovakia the company owns a local brand by the name of Petra [19]. PM’s strategy was to develop a constructive working relationship, which facilitated the obtainment of a majority shareholding in Tabak factory, and thus hold monopoly power over the Czech tobacco market [2].

British American Tobacco repeatedly lobbied the powers-that-be for entry to the Czech tobacco market. In 1995 it received permission to establish a small facility. From the beginning, the key factor was the change to mixed excise tax due to their diverse price portfolio. However, the government set proportional excise taxes which was in line with PM’s preferences and therefore by 2000 PM accounted for 80% of the market.

Imperial Tobacco Group is the third main player on the tobacco market, whose strategy is simply to follow the market leader.
4. Impact of the Global Crisis on the Tobacco Sector in Poland

Generally, the tobacco market consists of the retail sale of cigarettes, loose tobacco, chewing tobacco and cigars and cigarillos. The Polish tobacco market grew at a sluggish rate over the period from 2006 to 2010, as a result of sluggish sales growth in the cigarette category.

It is worth noting that the total sales of cigarettes in Poland has steadily decreased in recent years. Between 2006 and 2011 total sales fell from 72.4 billion units to 55.6 billion units (figure 3). On the one hand, this phenomenon may be attributable to the economic crisis; however, the decline in consumption between 2007 and 2008 (the beginning of the crisis) amounted to 6.8 billion pieces. In the crisis years, this decline was significantly lower and ranged from approximately 2 to 4 billion units per year. In other words, it is difficult to discern any direct impact of the crisis on the tobacco sector in Poland, as the decline in tobacco consumption had been observed previously. It can rather be attributed to the results of a change in lifestyle, regulations (e.g. prohibition of smoking in restaurants, bars, and also places of work), and the prohibition of tobacco product advertising.

During the same period, despite the significant decline in tobacco consumption in Poland, the nominal value of the sector has increased significantly (from 18.82 billion to 27.80 billion PLN). This was mostly the result of increasing the tax burden to which tobacco was subjected.

![Figure 3. The Polish cigarette market](image)

The crisis has, however, given rise to another worrying phenomenon - namely the ‘grey’ or parallel market. According to KPMG, the grey market for tobacco products was estimated in 2012 at over 12 billion units (6.2 billion cigarettes and 6 billion tobacco leaves for smoking). This already accounts for more than 20 percent of the tobacco market in Poland. The first half of 2013 brought a further dramatic outflow of consumers to the unregulated economy. According to a recent study of Almares, the market for illegal cigarettes is estimated at 15% of the market as a whole.

According to industry representatives, such rapid growth of the grey economy is the result of an excessively rapid increase in excise duty. As a result, a large number of less affluent consumers have escaped en masse to the grey market. Such a phenomenon mostly relates to the poorest consumers who are customers of the cheapest market segment constituting 60 percent of total consumption in Poland. It is estimated that losses resulting from the grey market for tobacco products in Poland deprive the state budget of more than 4 billion PLN per year [4].

Overall market growth is expected to decelerate in the forthcoming five years. The Polish tobacco market generated total revenues of $5.9 billion in 2010, representing a compound annual growth rate of 1.1% from 2006 to 2010. In comparison, the Chinese market increased by 6% and the Japanese market declined by 1.4%, over the same period, to reach respective values of $266.3 billion and $47.7 billion in 2010. In other words, market growth on the Polish tobacco market is slow but steady compared to the other regions. Moreover, Polish tobacco market has seen the increased introduction of legislation and government regulation with regard to smoking, which limits the existing players and discourages new entrants to the sector. The domination of large players coupled with advertising restrictions can be observed on the market.
For example, since 2003, Poland’s regulation has prohibited smoking in enclosed workplaces with the exception of designated smoking areas.

Therefore the question is, what is the growth forecast for the tobacco sector in the future? One estimates that the performance of the market should decelerate, with an anticipated growth of 1% for the three year period from 2013 to 2015, which is expected to lead the market to a value of $6.2 billion by the end of 2015. In 2015, the Polish tobacco market is forecast to have a value of $6,236.4 million, an increase of 4.9 percent since 2010. The compound annual growth rate of the market in the period from 2010 to 2015 is predicted to be 1% (table 2).

<table>
<thead>
<tr>
<th>Year</th>
<th>$ million</th>
<th>PLN million</th>
<th>EUR million</th>
<th>% growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>6,124.4</td>
<td>18,508.3</td>
<td>4,623.8</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>6,178.4</td>
<td>18,671.6</td>
<td>4,664.6</td>
<td>0.9%</td>
</tr>
<tr>
<td>2015</td>
<td>6,236.4</td>
<td>18,846.9</td>
<td>4,708.4</td>
<td>0.9%</td>
</tr>
</tbody>
</table>

Source: [24].

5. Impact of the global crisis on the tobacco sector in the Czech Republic

In contrast to Poland, the Czech tobacco market experienced rapid growth from 2006 to 2010 because of strong sales growth in the cigars and cigarillos category. In 2010 the tobacco market grew by 1.5%, generating total revenue of $2.2 billion. According to Datamonitor [9], the forecast for 2015 predicts an increase of 6.9% which would generate over $2.4 billion (figure 4) meaning that the economic crisis has not significantly affected the tobacco sector. On the other hand, it should be noted that the consumption of cigarettes has decreased by 1% over the last five years. In 2012, however, a fall of 2% was observed for the first time (table 3). Such a phenomenon mainly affected PM; however, due to export and the higher domestic price of cigarettes, the company generated a 12% higher profit than in 2011. On the other hand, Imperial tobacco reaped most of its profits from the sale of hand-rolled tobacco products. Such products became increasingly popular among young people, now with increased purchasing power and thus able to afford the higher prices of popular brands [18].

As in Poland, taxes levied on tobacco products are the main source of income as regards the budget in the Czech Republic. In 2013, an increase in excise tax on cigarettes from 2,10 CZK to 2,50 CZK per package was implemented. This increase related to lower quality cigarettes; however the excise tax for premium brands amounts to between 3 – 4 CZK/package. The increase allowed companies to raise their margin; yet the value of the market is expected to diminish by 4% [17].

Another effect of the economic crisis in Czech Republic was the elimination of some brands of cigarettes. For example, in 2013 Philip Morris closed down some of the traditional Czech brands (PETRA, SPARTA). These two brands were among the low-priced brands which had implemented a high price increase over the last 5 years. The other reason was that many smokers changed their smoking habits away from cheap cigarettes, increasingly preferring the roll-your-own varieties [22].
Table 3. Cigarette consumption in the Czech Republic 2008-2012 (annual averages per capita)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cigarette consumption (pcs.)</th>
<th>Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>2107</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>2071</td>
<td>-1.71</td>
</tr>
<tr>
<td>2010</td>
<td>2028</td>
<td>-2.08</td>
</tr>
<tr>
<td>2011</td>
<td>1988</td>
<td>-1.97</td>
</tr>
<tr>
<td>2012</td>
<td>1974</td>
<td>-0.70</td>
</tr>
</tbody>
</table>

Source: Own work

The overall consumption of cigarettes in the Czech Republic has been decreasing steadily since 2008. This phenomenon is due to the financial crisis which brought with it striking price rises, the effect of which was that Czech smokers started to economise and alter their habits. The economic recession did not influence the consumption of cigarettes among the older generation, as the consumption of cigarettes has slightly decreased as regards this demographic from 32% to 28% over the last 5 years. On the other hand, the younger population, that is to say people between the ages of 15 to 24, increased their consumption of cigarettes (table 4). Nowadays it is estimated at around 44.7%, of whom two-thirds smoke more than 10 cigarettes a day. The research from the Ministry of Health indicated that this is the result of stimulated advertising by tobacco companies, which is not sufficiently regulated under Czech Republic law [6].

Table 4. Average consumption of cigarettes per day in 2012

<table>
<thead>
<tr>
<th>Demographical characteristics</th>
<th>&lt; 5 pcs/day</th>
<th>5-9 pcs/day</th>
<th>10-14 pcs/day</th>
<th>14-24 pcs/day</th>
<th>≥ 25 pcs/day</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>8,9</td>
<td>19,7</td>
<td>28,9</td>
<td>32,2</td>
<td>10,3</td>
</tr>
<tr>
<td>Men</td>
<td>6,4</td>
<td>15,8</td>
<td>28,2</td>
<td>35,9</td>
<td>13,7</td>
</tr>
<tr>
<td>Women</td>
<td>12,1</td>
<td>24,7</td>
<td>29,7</td>
<td>27,5</td>
<td>6,0</td>
</tr>
<tr>
<td>Age</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15-24</td>
<td>8,8</td>
<td>25,0</td>
<td>32,5</td>
<td>28,8</td>
<td>5,0</td>
</tr>
<tr>
<td>25-44</td>
<td>8,1</td>
<td>24,2</td>
<td>27,3</td>
<td>31,7</td>
<td>8,7</td>
</tr>
<tr>
<td>45-64</td>
<td>9,0</td>
<td>12,3</td>
<td>29,5</td>
<td>34,4</td>
<td>14,8</td>
</tr>
<tr>
<td>65+</td>
<td>11,3</td>
<td>15,1</td>
<td>26,4</td>
<td>33,9</td>
<td>13,2</td>
</tr>
<tr>
<td>Education</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary</td>
<td>3,7</td>
<td>18,9</td>
<td>23,8</td>
<td>37,2</td>
<td>16,5</td>
</tr>
<tr>
<td>High school</td>
<td>12,1</td>
<td>18,2</td>
<td>33,3</td>
<td>28,8</td>
<td>7,6</td>
</tr>
<tr>
<td>University</td>
<td>20,0</td>
<td>17,5</td>
<td>27,5</td>
<td>30,0</td>
<td>5,0</td>
</tr>
</tbody>
</table>

6. Comparison

An analysis of the impact of the economic crisis on the consumption of tobacco in Poland and the Czech Republic reveals both similarities and differences. It should, however, be emphasized that the similarities outweigh the differences. Firstly, both in Poland and the Czech Republic the consumption of tobacco products decreased, which was the result of significantly higher prices, as well as changes in both the lifestyle and habits of smokers. Secondly, the value of the tobacco market in both countries increased at the same time (it is expected that this increase will amount to 6.9% over the period from 2010 to 2015 in the Czech Republic). Thirdly, the governments of both countries also significantly increased the tax burden on tobacco products as a way to improve the budgetary situation. It is also worth noting that, in both countries, the leading worldwide players have dominant roles. The market leader is Philip Morris, however this organisation’s market share in Poland amounts to approx. 39 %, whilst in the Czech Republic - 71%). This difference may, however, be attributable to the difference in size between the two countries.

In turn, an important difference is the size of the grey market, which in Poland is estimated at 20% of the market. Although there is no accurate data on the size of the market in the Czech Republic, it is certainly significantly lower.
7. Conclusions

Generally, however, it should be noted that the crisis had a moderate impact on the tobacco sector in both countries. The tobacco sector is a specific branch of the economy and thus cannot be compared with other branches which have experienced a significantly stronger impact from the crisis (e.g. the automotive industry). In the latter, demand significantly decreased, with the same (and sometimes even lower) prices; while in the tobacco sector, there was a moderate decrease in consumption which by contrast is mainly due to the significant increase in the price of tobacco products (higher taxes, including excise duty). The decrease in consumption has also resulted from changes in both the lifestyle and habits of society, as well as the ban on smoking in restaurants, bars, workplaces, etc.

It is difficult to speculate with any certainty what the future of production of tobacco in both countries will look like. The crisis did not have a significant effect; however the budgetary problems were the impetus behind higher taxes and thus the creation of a larger grey market (especially in Poland). One issue is clear - that because of the action carried out by the European Commission, apprehension among farmers is growing. This may suggest that the future will bring further deterioration. The more distant future of tobacco production is not yet known, and changes in the Tobacco Directive proposed by the European Commission justified struggle with compulsive smoking, e.g. banning of the sale of slim cigarettes, does not bode well. At the Visegrad Group summit, the Czech Republic stated that it disagrees with European directives as to the greater control of cigarettes. Poland seconded this opinion. The Czech and Polish governments both expressed fear that this will lead to an outflow of tobacco companies from Central Europe and thus bring about a rise in unemployment [7].

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