

Tobacco industry essay

[Business](#), [Industries](#)



Executive Summary The use of tobacco products can be traced back to the 9th century and has experienced strong periods of growth during the industrial age.

Since the 1800's the U. S tobacco industry has attracted taxes and regulations, however governments increased regulations and taxes when it was identified that there were adverse health effects associated with tobacco use. This limited the marketing strategies previously used by tobacco industries while also minimizing the consumer base. This created barriers to entry for the industry as it's consumers are extremely brand loyal with the perception of product differentiation. This has resulted in four major competitors dominating the industry.

The cost of capital associated with entering and exiting the tobacco industry has also acted as barrier to entry. Economies of scale can not be achieved until a consumer base is established, with the limits on advertising and consumer loyalty this will take a new entrant a considerable amount of time. While due to government initiatives, the consumer base is also in decline. This makes the overall tobacco industry unattractive to new entrants and would be considered to have a high risk of failure. New entrants also need to be involved with government agreements to avoid litigation from adverse health effects.

This requires a large amount of money to enter the agreement and the new entrant will need to continue payment towards this agreement to avoid any future litigation. The new entrant will also need to establish a supply chain to place its products at retail, this will create an issue for the new entrant as

it will effectively be competing against the four other tobacco companies for shelf space. The rivalry in the tobacco industry is strong, with the four tobacco companies being large corporations who are still attracting and maintaining consumers from previous marketing strategies used before heavy regulations were implemented. This means that the new entrant will not be able to attract these consumers away from the four main companies, as regulations prevent these marketing strategies from being used and the loyalty of the consumers is too strong. Michael Porters five forces model has been used on the tobacco industry, and it has been identified that the competitors rivalry is high, the threat of substitute products is low, threat of new entrants is low, and the bargaining power of the consumer and supplier is low.

This can be combined with the heavy regulations to create unattractive micro and macro environments for new entrants. Abstract Since extensive research identified tobacco products as being an adverse health hazard many regulations have been introduced in an attempt to reduce consumption. High taxes, public campaigns raising awareness, minimum age restrictions, packaging and labelling warnings, comprehensive banning on advertisement and cessation programs have been introduced as regulations in many countries. This creates high barriers to entry for new entrants to the market as traditional methods of marketing and promotion are not available, while the consumption of tobacco is in decline. New entrants have to compete with large companies that have high brand equity and an extremely loyal consumer base. Early entrants were not subjected to the level of restrictions imposed today, mass marketing activities were

successful and this can be combined with the addictive elements of tobacco to create lifelong consumers. Therefore, early entrants to the tobacco industry are able to remain relatively successful even with all the regulations and decline in consumers.

High amounts of capital are also required in order to compete successfully against the large established companies; this creates another deterrent into entering the market.

History The earliest use of tobacco products can be dated to the 9th century; with mass production commencing in the 1800's. Duke's American Tobacco Co created a global monopoly by 1911 with control of over 92% of the world's tobacco business. This monopoly was dissolved by the Sherman Anti-Trust Act (1890) with the emergence of major companies American Tobacco Co, Reynolds, Liggett & Myers Tobacco Company, Lorillard and British American Tobacco. (Cox, 2000, p. 117). This reduced barriers to entry in the tobacco industry effectively enabling new entrants and increased competition.

Marketing strategies increased the consumption of cigarettes and World War I saw "cigarette production to increase by 633% from under 10 billion per year to 70 billion per year". (Meyer, 1992, p. 1). This created an attractive loyal market of consumers addicted to cigarettes after the war. Further smaller independent companies subsequently enter the market. During this period taxes and regulations were in place; however a series of research onwards identified cigarettes as a major health problem, this subsequently increased taxes and regulations to today's standards. Current Market Takeovers and mergers have reduced the amount of competitors in

the tobacco industry, with four major competitors remaining in the United States of America (U.

S); Philip Morris, R. J Reynolds, British American Tobacco and Lorrillard. (fig 1.

0). (Brant, 2007, p. 29) Figure 1. 0 (Cox, 2000) When research discovered the adverse health affects of consuming tobacco, heavy regulations are established, such as; restrictions on advertising, high taxes, restriction of sales to minors, changes to packaging and labelling and research being made public. These restrictions resulted in a decline in consumers and tobacco companies lost the ability to actively attract consumers through traditional marketing methods. This means that if a new entrant entered the market, they would be unable to advertise their product, meaning that they would be unable to shift the consumer's perception of product differentiation from their current preferred brand. After many litigation issues arose from consumers claiming compensation for health issues, the four major competitors entered " the Tobacco Master Settlement Agreement (MSA) with 46 U.

S States to be exempt from liability associated with tobacco related illnesses in exchange for yearly financial payments". (Geyelin, 1998, p. 9).

The MSA can be seen as favouring the four major competitors over smaller competitors in the industry as the MSA places certain restrictions on pricing, which lessens the competition in the industry. Another issue arises when a tobacco company wishes to exit the industry. As the effects of consuming

tobacco are not instantaneous, tobacco companies will need to continue to make these yearly financial payments for an unknown period to avoid future litigation. This creates a barrier to exit for the new entrant. This means that if the new entrant fails in the industry, it is not as simple as just leaving the industry; there will still be cost associated for many years to come.

This barrier to exit effectively creates a barrier to entry as the exit costs are also considered by companies before a decision to invest is made. Furthermore, the World Health Organization (WHO) introduced a framework convention on tobacco control, " being signed by 168 countries representing over three billion people. This creates formidable barriers to entry as new entrants lack the production capacity, the brand name and the capital to compete in the industry" (American Journal of International Law, 2003, p 689). This also limits the new entrants ability to enter international markets; with similar regulations being in place outside its base of origin.

This means the new entrants product lifecycle and consumer base is limited as it may not be able to enter another market. With the rise of globalization, this creates another barrier to entry for the new entrant, as it will lose the economic cost from investing in another industry that is able to enter foreign markets. Loyalty " The cigarette brand enjoys the highest brand loyalty of all consumers' products, with less than 10% changing brands annually."(Wakefield, 2002, p. 416).

Research has proved that consumers select their brand at early stages of consumption. This means that the consumer may have been influenced by the heavy marketing campaigns before restrictions on advertising were

implemented. This has resulted in Philip Morris, British American Tobacco and Lorrillard's having loyal consumers with no need for further advertising. This creates a high barrier to entry for new entrants as it will be unlikely to attract many consumers away from their existing brand. While the new entrant will need to rely on new consumers of tobacco, this is a small consumer base as regulations have made tobacco unattractive. However, even new consumers of tobacco are familiar with the existing brands, from previous advertisements that are now banned or from brands of friends and family. Therefore, even though advertising is now restricted, previous campaigns are still successful and have created a perceived product differentiation. " Government policies restricting cigarette marketing have almost certainly made it more difficult for new firms to enter by taking away relatively cost-effective way of introducing new brands".

(Tremblay, 2007, p. 99). For example a new entrant is not able to advertise on television or radio.

This means that there are no traditional marketing methods that can be used by new entrants to attract consumers. Highly expensive methods of advertising is used by tobacco companies; such as sponsorship or product placement. Even these methods are regulated and can result in fines if the regulations are breached.

This adds to the capital the new entrant needs to enter the market. High brand loyalty has created a low threat of substitute products as the existing brands have created a high perceived level of differentiation for its brands. The existing competitors have developed strong brand equity over time,

which can not be replicated by a new entrant. For example, consumers still perceive differentiation in the brand Marlboro from the early marketing campaign the “ Marlboro Man” or Camel brands’ “ Joe Camel”. Due to regulations, the new entrant will be unable to replicate these campaigns and therefore they might not be able to differentiate its products or create strong brand equity. Loyalty extends up and down the supply chain, with the existing competitors having access to tobacco growers, manufacturers and retail outlets.

The existing competitors have a strong distribution chain and a new entrant may encounter difficulties establishing an independent distribution chain. For example, the existing competitors have allocated shelf space and agreements with major retail outlets, without the capital the new entrant may not be granted access to any shelf space. This means that the existing competitors can influence retail outlets to force the new entrant out of the market. Capital Requirements Existing competitors have the ability to utilize economies of scale and this cannot be replicated by a new entrant without a high capital. To be competitive the new entrant may need to establish a new subsidy for the tobacco industry to minimize duplication of effort and reduce management overheads; however without an established market share this will require a high capital outlay. Due to consumer loyalty, the new entrant will not be granted a market share on entry; this will take a considerable amount of time and effort. This means that the new entrant may need to operate at a heavy loss until a market share is established.

The decline in sales of tobacco products also acts as a deterrent to new entrants as there is no potential for future market growth. The existence of the MSA will also require the new entrant to make contributions to avoid litigation; however the new entrant has no involvement in the current amount of tobacco related illnesses. This would amount to a substantial amount of capital. The decline in sales combined with the high capital outlay results in an unattractive market to new entrants. (fig 2.

0) Figure 2. 0(Miller, 2006) Regulations Since heavy research identified adverse health effects from tobacco use, restrictions have been enforced to reduce the amount of tobacco usage. Regulations have been designed for demanding reduction, stopping passive smoking, disclosing ingredients, eliminating deceptive labels, introducing health warnings, raising public awareness, banning advertisements, creating cessation programs, restricting sales and sharing information.

(Rabin & Sugarman, 2001, p. 54). High taxes have been placed on tobacco products to reduce the demand of the products. This creates higher revenue for States enabling the funding to develop tobacco prevention programs, which also reduces tobacco consumption. Increasing taxes on tobacco products is an effective strategy to decrease demand; however it can be argued that this also increases illegal sales of tobacco products. Both of these factors should be considered unattractive for the new entrant, as it reduces the ability of the new entrant to control its prices. Regulations have been introduced to eliminate consumption of tobacco products in indoor

public locations, such as inside the workplace, public transport and shopping centres.

This reduces the amount of tobacco consumed while also reducing the amount of consumers. While warnings are placed on tobacco products and comprehensive public health warnings about the dangers of tobacco are developed. With regulations becoming more strict, the likely outcome would be a large decrease in tobacco consumers.

This means that the external political environment should be seen as a major deterrent for new entrants in the tobacco industry, as policies and regulations continue to be introduced, eliminating consumers and costing tobacco companies millions of dollars. A comprehensive ban on advertising has been enforced in many countries; this can be seen as the biggest deterrent for new entrants in the industry. Consumers have extreme brand loyalty developed when first commencing tobacco consumption; therefore to obtain a market share the company needs to 'get to' the consumer first. The combined effect of the other regulations has resulted in fewer new tobacco consumers. Therefore, the new entrant will need to target the existing market base. However, with the ban on advertising the new entrant effectively has no means of attracting consumers of its competitors. Even though the major competitors are no longer advertising using traditional marketing methods, previous campaigns have still captured a majority of the market. Competitive Intensity and Market Attractiveness To determine the competitive intensity and attractiveness of the tobacco industry, Michael Porters five forces theory will be utilized.

Threat of Substitute Products Due to regulations and the four major competitors in the industry the new entrant will be unable to compete on a price basis to gain consumers. While, due to the developed brand equity from the four major competitors, there is a perceived level of differentiation in their tobacco products. The taxes on tobacco products essentially dictates the prices tobacco companies can use; this means that competitors will be unable to use pricing strategies as an effected method of attracting consumers. Therefore, it should be seen that the threat of substitute products is low.

Threat of Entry of New Competitors There are high barriers to entry in the tobacco industry, this blocks new competitors and enables economies of scales to be utilized.

Access to distribution can be blocked, exit strategies exist, the industry is in decline, capital overlay is high, government polices are strict and retaliation from the major four competitors can be expected. This means that the threat of new competitors should be seen as low.

The Intensity of Competitive Rivalry The four major competitors should be seen as intense rivals who can compete aggressively. The market base is decreasing, so there is no industry growth, while a competitive advantage can not be easily obtained by a new entrant. Exit barriers can be seen as exiting due to the adverse health effects caused by tobacco. This means that if a competitor wishes to leave the industry, payments may still need to be made for the MSA to prevent litigation.

This indicates that the rivalry in the tobacco industry should be seen as high.

Bargaining Power of Consumers Consumers should be seen as having

little ability to control companies in the tobacco industry. Regulations control a major aspect of the industry, such as price, distribution and the information available. Research has proven that tobacco is addictive; therefore the goods should be seen as relatively inelastic to a degree. For example, taxes can be increased by 10% with only a small decrease of consumers. This means that consumers are unable to dictate conditions to tobacco suppliers. Bargaining Power of Suppliers There are over " 80, 000 farmers who produce tobacco in the U.

S using quota they own supplemented by leased quota". (Capehart, 2001, p. 9). With the demand for tobacco products decreasing and cheaper tobacco available internationally, suppliers of tobacco should be seen as in abundance.

This means that suppliers do not have the power to refuse to supplier or force terms on to tobacco corporations. (Adapted from Porter's Five Forces Theory) Conclusion In accordance with Michael Porter's five forces, the tobacco market is unattractive to new entrants as there is a low threat of substitute products, high barriers to entry, strong government policies and regulations, poor access to distribution, high capital requirements, low rate of industry growth and the bargaining power of suppliers. While new regulations are continuing to be implemented, making it even more difficult for a new entrant to establish a market base. The combined factors of the oligopoly in the tobacco industry, heavy regulations, required capital, consumer loyalty and reduction in consumers makes it difficult for new companies to enter the industry as the micro and macro environment

indicates that the new company in the industry will have a high risk with limited profitability.

References Adoption of Framework Convention on Tobacco Control (2003, July) American Journal of International Law, 97.

Brant, A. (2007). The cigarette century: the rise, fall and deadly persistence of the product that defined America.

New York. Basic Books Cox, H. (2000).

The global cigarette: origins and evolution of British American Tobacco.

Oxford University Press. Capehart, T (2001). Trends in the cigarette industry after the master settlement agreement.

USDA Tobacco Geyelin, M. (1998, November 23). "Forty-six states agree to accept \$206 billion tobacco settlement" Wall Street Journal Meyer, J. (1992, December 13). Cigarette century. American Heritage, 43, 1 - 6 Miller. T. (2006, March 8).

Cigarette sales in the U. S reach historic 55-year low. Press Release. Iowa Attorney General. Rabin, R & Sugaman, S (2001) Regulating Tobacco.

Oxford University Press. Tremblay, C. (2007).

Industry and Firm Studies. M. E Sharpe. Wakefield, M (2002, December 2008).

The cigarette pack as an image: new evidence from tobacco industry documents. Tobacco Control, 17, 416 - 421