Tobacco multinationals assess opportunities in China

Contributed by Euromonitor International
Monday, 18 April 2005
Last Updated Thursday, 15 September 2011

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Tobacco multinationals are looking to China - the biggest cigarette market in the world, in terms of volume sales â€“ for new opportunities. However, according to Euromonitor Internationalâ€™s new report "Tobacco in China", significant market penetration by international players is a long way off.

Since entering the WTO in late 2001, expectations have been raised that China would start to open its doors to foreign multinationals, bringing to an end the China National Tobacco Corporationâ€™s (CNTC) monopoly of the market. Recently, British American Tobacco announced that they had permission from the state to set up production in China - a statement that was later denied by the CNTC who used the opportunity to stress their protectionist stance. Currently, CNTC controls over 90% of volume sales in the tobacco market; whereas, the share of the market taken by multinationals is negligible and any foreign presence is bound by strict regulations. Although the country is expected to liberalise its borders, progress has been slow in order to protect domestic tobacco companies and sustain one of the Governmentâ€™s main income sources. In 2003, industrial tax from tobacco companies was estimated to have reached RMB145.6 billion, or nearly 9% of the stateâ€™s tax income.

Tariff cuts to benefit foreign entrants
Due to heavy import taxes, foreign tobacco brands sold in China are generally priced at a premium compared to their local counterparts. As a result, consumers tend to consider foreign cigarettes such as Camel, Kent and Marlboro to be too expensive, which has traditionally prevented foreign firms from gaining any significant market share. Since 1997, there has been only a gradual reduction in tariffs. January 2004, however, saw a fairly drastic cut on tariffs from 65% to 25% - a move that is expected to make foreign brands more price competitive in the Chinese market. As more foreign brands enter the market in the mid price range, demand is expected to grow. By 2009, Euromonitor International predicts that mid price cigarettes will be the most popular category, accounting for 45% of volume sales.

Lower tar contents good news for multinationals
Euromonitor Internationalâ€™s new research also identifies the trend towards lower tar content as having a positive impact on foreign manufacturers. Currently, Chinese consumers still prefer high tar cigarettes despite growing awareness of their health risks and the growing presence of mid tar cigarettes. Chinaâ€™s participation in the Framework Convention on Tobacco Control (FCTC) in late 2003, however, saw China agree to reduce the average tar content of cigarettes produced domestically to 12mg/stick by 2005, from around 14.3mg/stick in 2003. To fulfil its promise to the FCTC, the State Tobacco Monopoly Bureau (STMB) issued a regulation, which banned the sale of cigarettes above 15mg/stick by July 2004. Euromonitor predicts that this will benefit foreign brands, most of which have tar levels much lower than 15mg.

Legislation on distribution eases up
In January 2004, the Government also changed legislation that affects the distribution of foreign cigarettes in China. Previously, retailers had been required to apply for two licenses to sell cigarettes - one for domestic products and one for foreign brands. Now, retailers need only one license to sell both local and foreign brands, which will simplify foreign firmsâ€™ access to the market. Despite this development, CNTC still controls the industryâ€™s import quota and the distribution of foreign tobacco products. Euromonitor expects that the monopolyâ€™s licensing arrangement is unlikely to lead to any significant growth of foreign brandsâ€™ retail presence in the immediate future.

Protectionist measures prevail
Despite these favourable regulatory changes, Chinaâ€™s state monopoly is still taking measures to protect the domestic industry, which will continue to hurt foreign companies. CNTC has been pushing for consolidation among domestic players in order to develop large national players that can compete with global tobacco giants such as British American Tobacco. For example, four key players have been designated as the backbone enterprises of the domestic tobacco market - Yuxi Hongta Tobacco (Group) Co Ltd, Shanghai Tobacco (Group) Corp, Kunming Cigarette Factory and Changsha Cigarette Factory. Boasting an annual production of at least 500,000 cases, these players also own well-established brands with national presence, namely Chunghwa, Yunyan, Hongtashan and Changsha. The state bureau plans to expand the number of the backbone enterprises to six players with annual production capacity of at least one million cases over the next few years. These enterprises will be equipped with state of the art production technology on par with global standards.

The Chinese tobacco industry has evolved significantly since joining the WTO. Recent regulatory developments, such as the reduction on import taxes, are expected to have favourable repercussions for foreign tobacco manufacturers. However, Euromonitor International believes concerns that increasing competition from foreign players will disrupt the market, will result in protectionist measures by the Chinese Government in the immediate future. So far the Government has yet to agree to foreign investment by preventing foreign manufacturers, including joint ventures, from setting up production in China.

"Tobacco in China" is a new report by Euromonitor International. Its analysis presents an accurate picture of trends and developments impacting the national industry. This report includes detailed sector coverage of cigarettes, cigars and smoking tobacco.

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